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**CHALLENGES AND OPPORTUNITIES FOR THE NATIONAL
CONSTITUTIONAL SYSTEM IN DEALING WITH THE GLOBAL
INVESTMENT REGIME**

A CASE STUDY OF THE INDIRECT EXPROPRIATION DOCTRINE AND INVESTOR-STATE
ARBITRATION UNDER THE FREE TRADE AGREEMENT BETWEEN THE REPUBLIC OF
KOREA AND THE UNITED STATES OF AMERICA

Younsik Kim

Submitted for the degree of Ph.D.

School of Law, University of Edinburgh

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ABSTRACT

In 2011, Korea ratified the Korea-US Free Trade Agreement (KORUS-FTA). This treaty remains controversial in Korean society, particularly because many Koreans claim that the indirect expropriation doctrine under investor-state arbitration in the investment chapter will allow global investors to challenge governmental regulation justified by the Korean constitution. Despite such criticism, the KORUS-FTA indirect expropriation doctrine and the Korean constitutional property doctrine share more than might be expected in practice. However, this substantive doctrinal convergence between national and global legal systems does not eliminate all risks of conflict between the nation-state and global investors; conflicts can occur whenever two actors interpret the same text differently. Once an investment dispute happens, independent investor-state arbitration reviews governmental action according to independent interpretative rules.

Systems theory suggests that nation-states can turn such global challenges into opportunities by taking contextual control over global investment in relying on the global investment legal system of the global investment regime. The nation-state can convince global investors that the nation-state respects transnational investment mechanisms, whilst indirectly imbuing norm-making with minimum national interest without incurring serious damage to its reputation. To be specific, the nation-state can attract more foreign investors by accepting the indirect expropriation doctrine and the investor-state arbitration respected by global investors. Simultaneously, the nation-state can secure minimum control over global investment under legitimate regulatory power reflected in the same indirect expropriation clause. In addition, the nation-state can guide the investment tribunal to secure a balance between investment protection and the regulatory power of the host state by prescribing the proportionality principle. Contextual control can be a sub-optimal choice for the nation-state in the sense that it avoids a worst-case scenario by securing proportionality and predictability.

In order to make this measure more effective, the current global investment legal system needs to secure more commensurate autonomy or autopoiesis by furthering simultaneous and balanced structural coupling with a greater variety of social powers. In this context, global constitutionalism provides national constitutional tools for the nation-state; specifically, democratic participation in national treaty-making procedures and autopoietic structuralisation of the investment arbitration mechanism can make the substantive contents and application of global investment law fairer and more acceptable, not only to global investors and strong states, but also to social movements and smaller countries. In the context of the KORUS-FTA, the Korean government needs to make the treaty terms of indirect expropriation clearer through democratic participation. At the same time, the Korea should pay attention to making arbitration process reflexive to more various social interests, whilst protecting its operation from inappropriate influences. Such measures can prevent KORUS-FTA tribunals from making extremely unacceptable decisions to actors of the global investment regime, including the Korean government, although they could not guarantee ideal decisions that stratify all actors perfectly.

ABBREVIATIONS

AMCHAM Korea	American Chamber of Commerce in Korea
BIT	bilateral investment treaty
FTA	free trade agreement
FTADMC	Free Trade Agreements Domestic Measures Committee (South Korea)
FTAOC	Free Trade Agreement Opportunity Committee (South Korea)
FTC	NAFTA Free Trade Commission
GIL	global investment law (or global legal system)
GIR	global investment regime
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
ILO	International Labour Organization
IMF	International Monetary Fund
KORUS-FTA	Free Trade Agreement between the Republic of Korea and the United States of America
MAI	Multilateral Agreement on Investment
MMT	methylcyclopentadienyl manganese tricarbonyl
MMFEA	Ministerial Meeting on Foreign Economic Affairs (South Korea)
MTBE	methyl tertiary butyl ether
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PCB	polychlorinated biphenyl
PCIJ	Permanent Court of International Justice
TEPAC	Trade and Environment Policy Advisory Committee (United States of America)
U.K.	United Kingdom
U.S.	United States of America
U.S.S.R	Union of Soviet Socialist Republics
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USTR	United States Trade Representative
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

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DECLARATION

I declare that this thesis has been composed by myself and is my own work. No part of this thesis has been submitted for any other degree or professional qualification.

Parts of Chapter I and V will be published under the title of ‘The Policy and Institutional Framework for FTA Negotiations in Korea’ in James Harrison (ed) *The European Union and South Korea: The Legal Framework for Strengthening Trade and Economic Relations* (Edinburgh University Press, forthcoming).

Younsik Kim

16 October 2012

CHAPTER I

INTRODUCTION

I. BACKGROUND OF THE KORUS-FTA

This thesis examines how the nation-state can utilise a national and global constitutional mechanism to manage the challenges of the global investment field and to expand the relevant opportunities. In particular, the thesis proposes some Korean alternatives for dealing with indirect expropriation concerns under the investor-state arbitration mechanism of the Free Trade Agreement between the Republic of Korea and the United States of America (hereafter ‘KORUS-FTA’).

Although the Korean government has established a strategic policy to conclude many free trade agreements (hereafter ‘FTA’s) and bilateral investment treaties (hereafter ‘BIT’s), the Korean people have not paid enough attention to FTA-related issues.¹ Korean trade policy makers have pursued many of these FTAs in a bid to increase Korean investor access to foreign markets and attract foreign investment into Korea.² Since 2003, Korea has had an FTA policy road map; while participating in the WTO regime, Korea signed a series of ‘exploratory’ FTAs with Chile and Singapore which were not expected to have serious negative impacts on Korea’s main industries or legal system.³ Those FTAs did not receive much public attention at the time due to the fact that trade with those countries did not represent a significant portion of Korea’s overall foreign trade.

¹ While a BIT is a treaty that deals with investment issues, such as investment protection or dispute settlement, an FTA covers overall trade policies, such as customs or market openness. In practice, FTAs are prescribed in many different ways; many recent FTAs include a traditional BIT, but others do not. In this thesis, an FTA is an international agreement that includes an investment treaty, unless otherwise defined.

² The Korean government has concluded 8 FTAs since signing the first FTA with Chile in 2003. So far, the Korean government is in negotiation with over 50 countries to secure further FTAs. See Ministry of Foreign Affairs and Trade Republic of Korea, ‘FTA Status of Korea’ <http://www.mofat.go.kr/ENG/policy/fta/status/overview/index.jsp?menu=m_20_80_10> accessed 15 April 2012 (explaining the FTA status of Korea).

³ See generally Wonhyuk Lim, ‘KORUS FTA: A Mysterious Beginning and an Uncertain Future’ (2006) 30(4) *Asian Perspective* pp.175-77; Nakryoon Choi and Hongshik Lee, *A Sectorial Assessment of a Korea-US FTA and Policy Implications for the Korean Economy* (Korea Institute for International Economic Policy, 2007) pp.41-78 (explaining the general scheme of Korean foreign trade policy).

Despite some negative impacts on agriculture, there was no significant discussion about FTA concerns because the Korean economic structure was already dominated by the manufacturing and service sectors. Moreover, the Korean people expected losses in the agricultural industry to be balanced out by gains in the manufacturing industry. In addition, neither the Korean government nor Korean investors have ever been involved in investment arbitration under the FTAs or BITs.⁴

Korean policy makers viewed these exploratory FTAs as having been mutually beneficial.⁵ As a result, the Korean government has sought FTAs with major countries like Japan and the United States to promote economic prosperity and stabilise national security.⁶ Based on the experience of Korea's exploratory FTAs, the government announced the launch of the KORUS-FTA negotiations. Notably, KORUS-FTA proponents estimated that the positive impact of the KORUS-FTA would be incomparable to that of previous FTAs, since trade between Korea and the U.S. makes up a significant proportion of Korea's total foreign trade. The Korean and U.S. governments finally concluded the KORUS-FTA in 2007 after around 14 months of negotiations. After nearly four years of legislative discussion, the U.S. Congress gave its final consent to the treaty in October 2011; the Korean National Assembly followed suit in November 2011.⁷ The KORUS-FTA has been officially in effect since 15 March 2012.

II. GLOBAL CHALLENGES TO THE KOREAN CONSTITUTIONAL SYSTEM

The Korean governing party railroaded the KORUS-FTA's approval through the National Assembly⁸ despite some Koreans' warning that it would restrict regulatory powers exercised in the

⁴ In 1984, Colt Industries Operating Corporation submitted a legal claim to the ICSID arbitration panel against the Korean government. However, this claim was based not on a BIT or an FTA but on a dispute over technical and licensing agreements for the production of weapons. The parties agreed to settle and to discontinue the proceedings. See *Colt Industries Operating Corporation v. Republic of Korea*, ICSID No. ARB/84/2.

⁵ In the case of the Korea-Chile FTA, KOTRA (Korea Trade-Investment Promotion Agency) analyzed that the bilateral trade volume was increased by 454% (from \$1.6 billion to \$7.2 billion) within five years of the conclusion of the FTA. See KOTRA, *Achievement and Issues of Korea-Chile FTA* (KOTRA, 2009).

⁶ Lim (n 3) pp.178-79.

⁷ Article 24.5.1 of the KORUS-FTA requires the signatory states to complete the relevant legal requirements and procedures, such as legislative approval and establishment of implementation laws, in order to bring the treaty into force.

⁸ Representative Sundong Kim of the Democratic Labour Party sprayed tear-gas in the chamber in order to stop the surprise vote of the KORUS-FTA. See Myo-ja Ser, 'KORUS FTA Ratified in Surprise Vote' *Korea Joongang Daily* (23 November 2011) <<http://koreajoongangdaily.joinsmsn.com/news/article/article.aspx?aid=2944540&cloc=rss|news|joongangdaily>> accessed 15 April 2012.

public interest and guaranteed under Korean constitutional law.⁹ A Korean progressive left-wing party and various critical activist groups are consequently insisting on the renegotiation and termination of the KORUS-FTA. These opponents to the KORUS-FTA have accentuated the potential harm of many so-called ‘poisonous clauses’ which could force the Korean government to give in to American social and economic interests under the pretext of maintaining a stable Korea-US relationship. In relation to these ‘poisonous clauses’, this thesis focuses on the indirect expropriation clause as one of the contentious legal aspects of the KORUS-FTA. Although many Korean critical scholars and civic groups have taken up slightly different positions as to what these ‘poisonous clauses’ are, most of them seem to agree that the indirect expropriation doctrine presents the greatest potential threat to future Korean public policy planning in many areas.¹⁰

As Chapters II and III of this thesis explain, indirect expropriation under the KORUS-FTA entails an action or series of actions by the host state¹¹ that have ‘an effect equivalent to direct expropriation without formal transfer of title or outright seizure’.¹² Here, international investment lawyers have experienced many doctrinal difficulties in clearly discerning between mere restriction and restriction that causes ‘an effect equivalent to direct expropriation’.¹³ This doctrinal ambiguity has led the opponents of the KORUS-FTA to point out that this substantive norm could emerge as one of the most serious threats to the Korean public authorities in the treaty.¹⁴

These indirect expropriation concerns cannot be fully understood without analysing a unique procedural aspect of the KORUS-FTA: the investor-state dispute settlement mechanism. This thesis therefore discusses issues of investor-state dispute settlement in relation to indirect expropriation concerns. Since the 1960s, the international investment field has developed an unconventional type of dispute settlement, known as investor-state arbitration. Traditionally, there

⁹ See generally Gi-Bin Hong, *Invest-State Claim* (Nogsaeakpyeongnonsa, 2006) (regarding the critical points of view on the KORUS-FTA).

¹⁰ *ibid* pp.63-86; Hae-Young Lee, ‘Carefully Selected 11 Poisonous Clauses of the KORUS-FTA’ (2011) <http://h21.hani.co.kr/arti/economy/economy_general/30589.html> accessed 15 April 2012. In fact this clause was one of the most controversial issues in the negotiation of the KORUS-FTA. See Choi and Lee (n 3) p.216.

¹¹ This means the state where the foreign investment is made under the investment treaty.

¹² Free Trade Agreement between the Republic of Korea and the United States of America (KORUS-FTA) Annex 11-B.3. See also Rosalyn Higgins, ‘The Taking of Property by the State: Recent Developments in International Law’ (1982) 176 *Recueil des Cours* pp.322-54; Rudolf Dolzer, ‘Indirect Expropriation of Alien Property’ (1986) 1(1) *ICSID Review: Foreign Investment Law Journal* (regarding a classical understanding of indirect expropriation).

¹³ OECD, “‘Indirect Expropriation’ and the ‘Right to Regulate’ in International Investment Law (Working Papers on International Investment No. 2004/4)’ (2004) <<http://www.oecd.org/dataoecd/22/54/33776546.pdf>> accessed 15 April 2012.

¹⁴ Sang Hie Han, ‘Constitutional Analysis on the Expropriation Clause of the KORUS FTA’ (2007) 9 *Sugang Legal Study* pp.60-93.

have been two main ways for foreign investors to ask for compensation for damages caused by the host state on the basis of an investment treaty. Firstly, a foreign investor could submit a legal claim to a public court of the host state; alternatively, the home state¹⁵ could bring a claim on behalf of its investors to state-to-state arbitration. By contrast, the contracting parties to the treaty consent to delegate the power of conflict resolution to an independent tribunal, through which an individual investor can raise a direct claim against the host state. This system is different from national conflict resolution in the sense that the independent tribunal reviews the case without any legal or political bias in favour of the host state. Additionally, a peculiar feature of this form of dispute settlement is that an individual is entitled to submit a claim without consultation with the home state. If the host state fails in establishing a successful defence against the investor before the tribunal, it assumes liability for the payment of damages.¹⁶

Under the KORUS-FTA mechanism, the indirect expropriation doctrine, combined with the investor-state dispute settlement mechanism, carries the risk of discouraging constitutionally justifiable regulation by the Korean government.¹⁷ Indeed, almost all government regulation of investment carries the possibility of negative effects on property. In such cases, the Korean Constitutional Court consistently recognises the social obligation of the investor to tolerate such negative effects as long as they are proportional to the public interest pursued.¹⁸ On the other hand, international investment law has been blamed for the chaotic development of indirect expropriation jurisprudence over the last two decades.¹⁹ In particular, some tribunals under the North American Free Trade Agreement (hereafter 'NAFTA') have not paid due attention to legitimate regulatory power in expanding the concept of indirect expropriation. Consequently, foreign investors have abused this rule to freeze many constitutionally justifiable government actions, like environmental protection, by arguing that those regulations would have adverse effects regardless of the intentions of the host states.²⁰

¹⁵ This refers to the state from which the investor originated under the investment treaty.

¹⁶ See generally Zachary Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2004) 74(1) *British Yearbook of International Law*.

¹⁷ Han (n 14) pp.60-93.

¹⁸ 10-2 KCCR 927, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

¹⁹ See generally Anne K. Hoffmann, 'Indirect Expropriation' in August Reinisch (ed) *Standards of Investment Protection* (Oxford University Press, 2008) pp.151-55 (describing the current state of the indirect expropriation discussion).

²⁰ e.g. Public Citizen, 'NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy' (2001) <<http://www.citizen.org/documents/ACF186.PDF>> accessed 15 April 2012 (explaining notorious NAFTA cases).

Many Korean critical commentators anticipate that the notorious experiences of the NAFTA will repeat themselves in the KORUS-FTA.²¹ In this context, the stable future implementation of the KORUS-FTA depends on how accurately the challenges presented by the KORUS-FTA are analysed, and how those obstacles would be managed.

III. UNPRODUCTIVITY OF CURRENT DISCUSSIONS ON THE KORUS-FTA

Although many people are engaged in nationwide debate over the KORUS-FTA, the pros and cons of this treaty appear to be ideologically distorted in Korea. In fact, many negative Korean views about the KORUS-FTA seem to be associated with uncertain fears which derive from anti-American or anti-capitalist sentiments. In this sense, the experiences of the Free Trade Agreement between the Republic of Korea, of the One Part, and the European Union and Its Member States, of the Other Part (hereafter 'Korea-EU FTA'), and the Comprehensive Economic Partnership Agreement (hereafter 'Korea-India CEPA'), provide meaningful references in assessing the unproductive state of the current KORUS-FTA discussion.

The negotiation and conclusion of the Korea-EU FTA and the Korea-India CEPA began later than those of the KORUS-FTA. However, neither the Korea-EU FTA nor the Korea-India CEPA have faced any significant criticism, and both were approved by the legislature without any particular difficulty. Moreover, some Koreans consider the Korea-EU FTA to be a 'less poisonous' or even a 'good' FTA because it contains no indirect expropriation or investor dispute settlement clauses.²² However, the future of the Korea-EU relationship is expected to show a different picture as the pre-Lisbon Treaty framework in place at the time of the Korea-EU FTA negotiations did not then allow the EU authorities to deal with investment issues in FTA negotiation. However, the Treaty of Lisbon has now conferred competence on the EU authorities to deal with these investment issues and Korea and the EU can now therefore negotiate the establishment of a new BIT or add an investment chapter to the Korea-EU FTA in the future.²³ Against this backdrop,

²¹ e.g. Hong (n 9); Gi-Ho Song, *Handbook of the KORUS-FTA: A Commentary of the KORUS-FTA for Government Officials* (Noksaengpyeongnonsa, 2007).

²² Hae-Yoeng Lee, 'Why Are People Silent to KOREA-EU FTA?' *Midiaus* (29 April 2009) <<http://www.mediaus.co.kr/news/articleView.html?idxno=6468>> accessed 15 April 2012 (regarding a critical comment on this public attitude).

²³ Steffen Hindelang and Niklas Maydell, 'The EU's Common Investment Policy – Connecting the Dots' in Marc Bungenberg, Joern Griebel and Steffen Hindelang (eds), *European Yearbook of International Economic Law (Special Issue: International Investment Law and EU Law)* (Springer Berlin Heidelberg, 2011) (regarding the general understanding of the EU common investment policies in the post-Lisbon era).

indirect expropriation, combined with investor-state dispute settlement, will emerge as a controversial issue in the future discussion of the economic relationship between Korea and the EU. More interestingly, Koreans have not expressed strong opposition to the Korea-India CEPA, even though it does include clauses on indirect expropriation²⁴ and investor-state dispute settlement.²⁵

Given these facts, it is difficult to find a persuasive reason why Korean activists now denounce the FTA with the United States after their long silence over other so-far concluded treaties.²⁶ In this context, it might look circumstantially convincing to claim that vague fear, rooted in anti-American sentiment, has indeed produced negative opinions regarding the KORUS-FTA. This fear comes from Korea's conventionally ambivalent attitude toward the U.S. Indeed, Korean people have expected various benefits from the Korean-US relationship, and have, at the same time, suffered a feeling of being victimized by the U.S. because Korea has experienced the unilateralism of the U.S. as a superpower. Additionally, fear and antipathy towards the expansive powers of global capitalism after the 2008 global economic crisis might have fuelled this negative attitude toward the KORUS-FTA.

Taking advantage of these vague public concerns, some critical activists seem to exaggerate the potential harms of the investor-state arbitration mechanism. First of all, foreign investors tend to employ investor-state arbitration less often than KORUS-FTA opponents think. Although the investor-state arbitration framework was established in the 1960s, it was not until nearly two decades later that the first treaty-based claim was brought before an ICSID arbitration panel in 1987.²⁷ Since then, innumerable transactions and contracts have been made within the framework of over 2,600 BITs and FTAs around the world,²⁸ whilst only around 390 cases have gone through the investment arbitration system by the end of 2010.²⁹ In many of these cases, host states have been involved in disputes due to apparently malicious measures which are blamed on their relatively undeveloped legal systems. Given the state of Korean legal development, that many

²⁴ Comprehensive Economic Partnership Agreement (Korea-India CEPA) Article 10.12.1.

²⁵ *ibid* Article 10.21.

²⁶ The Korean government has established many BITs since the 1960s. 80 of all the effective 85 Korean BITs with other countries have provisions for investor-state dispute settlement. See Ministry of Foreign Affairs and Trade Republic of Korea, 'Counterarguments against So-called "KORUS-FTA Poisonous Clauses"' (2011) p.13 <http://www.fta.go.kr/new/ftakorea/korea_psd2_read.asp> accessed 15 April 2012.

²⁷ *Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka*, 27 June 1990, Award and Dissenting Opinion, ICSID No. ARB/87/3. See also Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration* (Sweet & Maxwell, 2004) pp.565.

²⁸ UNCTAD, 'Recent Developments in International Investment Agreements' (2009) p.2 <http://www.unctad.org/en/docs/webdiaeia20098_en.pdf> accessed 15 April 2012.

²⁹ UNCTAD, 'UNCTAD IIL Issues Note: Latest Developments in Investor-State Dispute Settlement' (March 2011) p.2 <<http://www.unctad.org/Templates/Page.asp?intItemID=6205&lang=1>> accessed 15 April 2012.

claims would be raised under the KORUS-FTA, looks questionable. Additionally, a quantitative analysis of the decade's experiences of the NAFTA, which many critics consider to be characterised by damaging applications of 'poisonous clauses', shows that host states lose arbitrations relatively rarely. According to Jeong's analysis, foreign investors won in only 6 of the 18 cases decided under NAFTA arbitration between 1994 and 2008 – when the KORUS-FTA was heavily discussed in Korea.³⁰ At minimum, it is an exaggeration to claim that investor-state arbitration necessarily works in favour of U.S. investors and U.S. interests. In reality, American investors have submitted 27 claims against the Canadian government and 18 against the Mexican government to NAFTA arbitration between 1994 and 2010. However, American investors have been successful in only 2 of 12 decided cases against Mexico and 3 of 10 decided cases against Canada.³¹

As will be seen in Chapter III, many of the rules of the notorious NAFTA cases, which some critical commentators have heavily cited, have been challenged in the development of international investment law over the last decade.³² NAFTA jurisprudence presents only a part of international investment law, even if the doctrinal significance of the NAFTA cases cannot be completely ignored.³³ Therefore, KORUS-FTA negotiators like other nation-states have attempted to follow the new trends in international investment law concerning indirect expropriation, rather than NAFTA jurisprudence.³⁴ In addition, the wording of the KORUS-FTA incorporates more national legal doctrines than the other U.S. FTAs concluded before the 2004 U.S. Model BIT. As a result, the KORUS-FTA's wording strives to induce the KORUS-FTA tribunal to take an approach similar to the Korean Constitutional Court, which respects the regulatory power of the host state as long as it is proportional to the public purpose of the relevant regulation. This is outlined further in Chapter II. Indeed, this proportionality approach concurs with the general direction of other recent investment arbitration practices.³⁵ Although, as some Korean constitutional lawyers have noted, there are some doctrinal differences between Korean law and the jurisprudence of international

³⁰ Soo-Bong Jeong, *Analysis on KORUS-FTA Investment Chapter* (Ministry of Justice in Republic of Korea, 2008) p.13.

³¹ Ministry of Foreign Affairs and Trade Republic of Korea (n 26) p.15.

³² UNCTAD, *Expropriation, UNCTAD Series on Issues in International Investment Agreements II* (United Nations, 2011) pp.80-142 <http://archive.unctad.org/en/docs/unctaddiaeia2011d7_en.pdf> accessed 15 April 2012 (mapping out the overview of indirect expropriation doctrine in the recent international investment law).

³³ UNCTAD, 'Investor-state Dispute Settlement and Impact on Investment Rulemaking' (2007) pp.56-60 <http://www.unctad.org/en/docs/iteiia20073_en.pdf> accessed 15 April 2012.

³⁴ *ibid* pp.75-76 (explaining the general trend of other states in drafting the expropriation clauses).

³⁵ *ibid* pp.57-60.

investment law,³⁶ there are more commonalities than differences in the sense that both systems share the same legal principles: balancing the protection of an individual's property with the regulatory powers of a democratic government. At the very least, it is hard to say that the doctrinal differences between Korean national law and international investment law are so severe that all government actions are totally prevented.

Nevertheless, KORUS-FTA proponents seem to overlook the fact that risk is a matter of probability. Despite the low probability of a risk, no one can guarantee that the risk will not occur, as long as there remains a structure through which it can do so. Indeed, nobody can be certain that the Korean government will not become embroiled in investment disputes under the KORUS-FTA. More significantly, the unforeseen occurrence of real problems can occur, whilst not in the 99% of usual circumstances, in 1% of unusual ones.

In such unusual circumstances, the textual similarities between the Korean Constitution and the KORUS-FTA do not formally prevent foreign investors from challenging constitutionally justifiable government regulations – even if they could reduce the probability of disputes in practice. Although Korean government officials would take measures on the basis of their own interpretation of the KORUS-FTA, U.S. investors could submit a claim to KORUS-FTA arbitration based on a different interpretation of the same clause. Here, the problem is not only attributable to substantive discrepancy but also to the procedural aspects of investor-state dispute settlement. In any case, the nation-state under the KORUS-FTA cannot control the occurrence of disputes between the investor and the host state directly.

Although only a small number of disputes have so far been resolved through the investor-state dispute settlement process, international investment law is evolving quickly. The number of cases has increased significantly since the late 1990s with an eye-catching proliferation of BITs and FTAs.³⁷ Even if the current jurisprudence of international investment law is deemed to be somewhat in accordance with Korean law, the interpretative gap between the Korean courts and investment arbitration could be broadened in the future. If so, nation-states cannot expect to control the global development of jurisprudence because it is constantly changing through a closed network of cross-references between investment arbitration decisions.

³⁶ e.g. Ha-Myoung Jeong, 'The Meaning of "Expropriation and Compensation" at Proposed Korea-U.S FTA Text and the Government's Police Power' (2007) 8(3) Public Law Studies p.59. See also Seung Pil Choi, 'Several Matters on Public Law of U.S.-Korea Free Trade Agreement' (2008) 36(3) Public Law pp.520-24 (mapping out various opinion concerning the doctrinal affinity between the Korean constitutional property clauses and indirect expropriation provisions of the KORUS-FTA).

³⁷ Hong (n 9) pp.158-61.

More significantly, even just one lost case carries a risk of inflicting considerable harm because foreign investments usually involve hugely expensive long-term public projects. Of course, almost all awards produced by investment arbitrations are involved in pecuniary obligations in order to avoid any direct restrictions on the sovereign power of the nation-state. From a legal perspective, a responding state could continue a disputed policy as long as it could pay compensation to the claimant, because the illegality in international law does not necessarily affect legality under domestic law. However, *de facto* influences are often strong and enforceable enough to influence host states to follow the global investment rule rather than their own domestic constitutional doctrine. Host states usually attempt to reach a compromise or conciliation before or during proceedings of investment arbitration in order to avoid either the payment of massive compensation or damage to their investment reputation. In the course of such a compromise, the nation-state could promise the withdrawal of a certain government measures or regulations on the condition of a reduction in compensation due or the withdrawal of an investor's submission to the arbitration institution. In *Ethyl vs. Canada*, the Canadian government gave up its ban on importing a gasoline additive into Canada, when the U.S. investor, Ethyl Corporation, indicated it would raise a claim for damages of \$251 million on the grounds of the indirect expropriation clause. Eventually, the Canadian government promised to pay \$13 million for legal fees and damages, and to issue and advertise a statement which declared that the methylcyclopentadienyl manganese tricarbonyl (MMT) had not been proven to be hazardous, so that the government could settle with Ethyl.³⁸

As a result, a host state can be compelled to follow international investment law in order to avoid the risk of investment claims. The attitudes of the nation-state, under the KORUS-FTA, could be explained by the so-called 'regulatory chilling' or 'chilling effect'.³⁹ Here, whether it won or lost, a government's involvement in arbitration would hinder its desire and ability to advance future proposals of social policy because of the uncertain risk of future claims. This effect might be more apparent in investment-importing countries like Korea; Korea is very sensitive to its bad reputation among investors which entails the risk of decreasing future foreign direct investment. Thus, under the KORUS-FTA, when the state attempts to establish regulations for public purposes, it might consider not only the domestic constitution but also the rules of international investment.

³⁸ Public Citizen (n 20) pp.8-10.

³⁹ Vicki Been and Joel C. Beauvais, 'The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine' (2003) 78(1) New York University Law Review pp.132-35; Gonzalo Guzman-Carrasco, 'Indirect Expropriation in U.S. Free Trade Agreements: From the U.S. Trade Act of 2002 and Beyond' (2004) 4 Revista International Law pp.287-89; Jack J. Coe Jr and Noah Rubins, 'Regulatory Expropriation and the *Tecmed* Case: Context and Contributions' in Todd Weiler (ed) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May, 2005) pp.598-600.

Furthermore, if it looks questionable to the government whether the policies involved constitute expropriation, then the government would be more likely to abandon the relevant policies or take a less active position in order to circumvent claims for indirect expropriation.⁴⁰

IV. CONTRIBUTIONS AND QUESTIONS OF THIS THESIS

This study aims to contribute to a productive discussion of the KORUS-FTA. Of course, the future of this agreement depends fundamentally on the Korean people's political will. Nevertheless, it is questionable whether the risks and opportunities are being explained fully enough for the people to make a prudent decision over the KORUS-FTA. The global investment legal system, introduced by the KORUS-FTA, seems to provide appropriate challenges and opportunities for Korea as a nation-state. Nevertheless, its opponents and proponents seem either to overstate or to downplay the risks and opportunities of indirect expropriation and investor-state arbitration, according to their own political positions. It is undeniable that the treaty's potential for harm could inflict enormous damage on Korean society. Nonetheless, it is too easy to claim that Korean policy makers have simply been captured by American imperialism, because the government of the United States is equally exposed to the risk of investment claims by Korean investors.

Another important point is that a fair assessment of the risks and opportunities entailed cannot be completed without proposing convincing alternatives for dealing with the risks and

⁴⁰ Recently, the Korean government has withdrawn a pre-announcement of its intention to revise the Enforcement Rules of the Postal Savings and Insurance Act. The Korean press revealed that the government, in the process of collecting the opinions, received a letter of complaint from the American Chamber of Commerce in Korea (hereafter, AMCHAM Korea). The AMCHAM Korea argued that the new policy would shrink the private insurance industry and that the revision process has a risk of violation of the transparency clauses of the KORUS-FTA Article 13.11.9 and the relevant Confirmation Letter (Cross-Border Financial Services) because of the very short notice of the amendment (8 days). The Korean government stated that Korean insurance companies also had complained heavily about the amendment and the government plans to reintroduce a new proposal after allowing enough time to review it. Nevertheless, some people point out that the Korean government was implicitly influenced by the AMCHAM Korea piggybacking on the KORUS-FTA. Although this is not directly related to the investment issues under the Chapter 11 arbitration, it implies that the investment protection under the KORUS-FTA could in the future impose an unseen burden so as to shrink the government actions in various areas. See Eun-Joo Jung, 'AMCHAM Interferes in Domestic Policies through FTA' *The Hankyoreh* (7 January 2012) <http://english.hani.co.kr/arti/english_edition/e_business/513802.html> accessed 15 April 2012; Yonhap News Agency, 'National and International Companies Challenging the Increase in Value Limitation on Sale of an Insurance Product by Korea Post' *Yonhap News* (5 January 2012) <<http://www.yonhapnews.co.kr/bulletin/2012/01/05/0200000000AKR20120105064900017.HTML>> accessed 15 April 2012.

opportunities. In other words, how can the Korean government attract foreign investment without any promise of adopting the global legal mechanism for investment protection? Conversely, despite the acceptance of the global investment legal system, is it possible for the nation-state to control foreign investors in accordance with national constitutional goals?

The current situation of the KORUS-FTA discussion, combined with an ideologically distorted assessment of its risks and opportunities, seems to hinder any productive discussion of the KORUS-FTA. In this context, the most urgent task of this thesis is to analyse how the challenges and opportunities occasioned by the treaty will happen; specifically, whether the discrepancy between indirect expropriation under the KORUS-FTA and Korean constitutional property law is so unbearable as to thwart the major constitutional tasks of the Korean government. Next, why does the nation-state wish to accept indirect expropriation and investor-state dispute settlement despite the risk of disruption for the government's policies? Lastly, if Korea were to accept the KORUS-FTA, is there any national or global constitutional mechanism that would allow the Korean government to utilise the opportunities on the one hand and reduce – even if not eliminate – the possible risks on the other?

V. OUTLINE OF THE THESIS

In this context, Chapter II explains the structure of Korean constitutional property rights before Chapter III compares the concept of indirect expropriation under the KORUS-FTA with Korean property law at the level of substantive doctrines. Through this doctrinal comparison, Chapter III establishes that there are more commonalities than differences between the two legal precepts. At the same time, that chapter points out that an insuperable gap remains as a potential source of anxiety for the Korean government because of the peculiar nature of investor-state dispute settlement. Chapter III therefore implies that the substantive problems of indirect expropriation concerns cannot be successfully solved without some theoretical consideration of the procedural aspects of the KORUS-FTA. Chapter IV goes on to apply the framework of the global law of systems theory to the global investment field, so as to demonstrate the evolution of global investment law. This theoretical framework may help Chapter V to explicate the risks and benefits of encouraging the global investment law. Moreover, Chapter V assumes that today's nation-states are caught in a global dilemma, where both direct intervention and non-intervention within the global investment field cause unexpected backlashes. Against this background, that chapter uses Teubner's framework of contextual control which can help the nation-state to use the autonomy of

the global legal system creatively. Contextual control could allow the nation-state to attract foreign investment, on the one hand, and maintain a minimum scope of normative predictability over global investment within a controllable level, on the other. Chapter V therefore suggests several alternatives that the Korean government can consider from the perspective of national and global constitutionalism in order to reduce the risks of global investment law and extend its benefits. Chapter V will conclude that current global investment law has some flaws that preclude effective contextual control due to its lack of autonomy. Therefore, the global investment regime needs a set of institutional facilities that can protect its legal autonomy from unjustifiable economic or political impacts. This thesis will ultimately propose the global application of the traditional heritage of national constitutionalism, which attempts to protect legal autonomy from the inappropriate influences of non-legal social systems.

CHAPTER II

PROTECTION AND RESTRICTION OF PROPERTY IN THE KOREAN CONSTITUTION

I. INTRODUCTION

This chapter will contribute to Chapter III's discussion of the similarities and differences in property protection and restriction between the KORUS-FTA and the Korean Constitution. As outlined in the introductory chapter, the indirect expropriation provision in the KORUS-FTA allows a foreign investor to raise a claim before investor-state arbitration where the investor alleges that the host state's public policy causes an expropriation-like effect without full market value compensation in practice. Some Korean constitutional lawyers have argued that the Korean Constitution does not prescribe any concept similar to indirect expropriation.¹ However, this does not mean that the two doctrines are based on very different legal contexts as regards property protection and restriction. Here, a comparative study between the two legal systems cannot be instructive as long as it focuses only on whether one concept, found in one legal system, also exists in the other system. Rather, this thesis proposes a practical approach towards examining how differently or similarly the two legal systems solve the same problem. In other words, can Korean property owners sue the government in a situation of indirect expropriation where a regulation for the public interest causes an expropriation-like effect? In such a case, would a Korean court review the case in a totally different way from a KORUS-FTA tribunal?

In this regard, this chapter, as a preliminary discussion leading to Chapter III's comparative analysis, aims to gain an overview of property protection and restriction in the Korean Constitution, based mainly on *current* court cases. Therefore, Part II provides a brief sketch of the social and legal backgrounds associated with Korean property rights. Then, Part III examines the

¹ e.g. Sang Hie Han, 'Constitutional Analysis on the Expropriation Clause of the KORUS FTA' (2007) 9 Sugang Legal Studyp.60-93.

constitutional foundations of the property rights enshrined in the Korean Constitution. From Part IV, the chapter looks at the structural elements of Korean property clauses one by one. Part IV begins by examining the content-and-limits clauses associated with the social-obligation-based restriction of Article 23(1)'s second sentence and (2). Part V goes on to articulate the meaning of public interference under Article 23(3) of the Korean Constitution. Lastly, Part VI examines one of the most controversial issues in Korean property rights; namely, a structural relation between the social-obligation-based restriction of Article 23(1) and (2) and the public restriction of Article 23(3). This discussion plays a crucial role in guiding the Korean Constitutional Court to review the constitutionality of non-compensated regulations that restrict property in the public interest.

II. SOCIAL AND LEGAL BACKGROUNDS IN RELATION TO KOREAN CONSTITUTIONAL PROPERTY RIGHTS

A. Tradition of strong state power

Like other countries, Korea has a very complicated system of property rights that is influenced by its deep-rooted historical and social context.² Initially, Korean constitutional settings were founded on a compromise between socialism and liberalism. After liberation from Japanese rule, nation-building discourse suffered from an extreme conflict between the political right and left.³ Against this backdrop, the constitution's framers tried to find a middle way: 'somewhere in between liberal free marketism and state socialism'.⁴

Nevertheless, Korean constitutional practice had shown a tendency to support strong governmental regulatory power in restricting property rights. The wartime government of the 1950 Korean War, and the authoritarian governments established by military coups of the 1960s and 1980s, had exercised strong state-driven regulatory power. These regimes, which had come to power illegitimately, tried to gain public support by promoting rapid economic growth whilst

² A. J. Van der Walt, *Constitutional Property Clauses: A Comparative Analysis* (Juta, 1999) (explaining the complicated historical and doctrinal contexts of property law in other countries).

³ See generally Young-Soo Chang, 'Historical Implications of 1948 Enactment of Constitution' (2008) 51 Korea University Law Review; Yong-Ok Shin, 'Korean Constitution Founders' Drafts and Their Political Directions' (2008) 51 Korea University Law Review.

⁴ Byeong Cheon Lee, 'Political Economy of Korean Development after Liberation: *A Critical Reflection*' (Autumn 2006) Korea Journal pp.58-60.

turning a blind eye to civil rights abuses and bureaucratic corruption.⁵ Ironically, the accomplishments of illegitimate authoritarian rule gave birth to a legitimate democratic government. Economic improvement contributes to political liberty because the people, educated and awakened by economic prosperity, tend to become more interested in political issues such as distributive justice and human rights. The 1987 Democratisation Movement was fuelled by the 1980 Gwang-Joo Massacre (where the military government killed and injured more than 5,000 citizens) and the 1987 Great General Strike.⁶ Korea was eventually able to achieve both economic and political development by amending its constitution.

Nevertheless, the judiciary has upheld broad governmental discretion over the restriction of property rights in the interests of social welfare. The 1987 Constitutional Amendment animated numerous constitutional rights which had previously been prescribed but never enforced. Despite the incorporation of a detailed bill of social rights into Korea's previous constitutions, the commitment of the authoritarian military government to these rights extended no further than empty phrases for a long time. Indeed, this list of constitutional rights was seen as little more than a symbolic text allowing the government to defend itself against international pressure regarding human rights abuses. However, the newly-amended constitutional setting helped the Korean public to focus more on redistribution issues, which are related to the social rights enshrined in the Korean Constitution. Consequently, the people wanted the government retain the power to carry out its constitutional tasks, namely, in promoting distributive justice. The Supreme Court of Korea (hereafter 'the Korean Supreme Court') has upheld the constitutionality of many regulations restricting property rights without careful consideration of the issues. As will be discussed below, the Supreme Court with only cursory arguments found that non-compensated property restrictions imposed by government policy maintained constitutional proportionality between the constitutional requirement to fulfil social obligations and the suffering of property owners.⁷

⁵ Sang Bum Han, 'The Fundamental Human Rights and Korean Constitutional Government in 50 Years' (1998) 5 Asia-Pacific Public Law Review pp.10-22. See also Moon-Hyeon Kim, *Social- and Economic Order and Property* (Beobwonsa 2001) pp.359-64; Byeong Cheon Yi (ed), *Development Dictatorship and Park Chung Hee Era* (Changbi, 2003); Dong-Myeon Shin, *Social and Economic Policies in Korea: Ideas, Networks and Linkages* (Routledge, 2003) pp.77-82.

⁶ Shin (n 5) pp.107-110; Sunhyuk Kim, 'State and Civil Society in South Korea's Democratic Consolidation: Is the Battle Really Over?' (1997) 37(12) Asian Survey; Sunhyuk Kim, *The Politics of Democratization in Korea: The Role of Civil Society* (University of Pittsburgh Press, 2000); Samuel S. Kim, *Korea's Democratization* (Cambridge University Press, 2003) (explaining the history of the Korean dictatorship and democratisation).

⁷ e.g. Supreme Court of Korea Decision 89Bu2 Declared May 8, 1990; Supreme Court of Korea Decision 94Da54511 Declared December 24, 1996.

B. Rethinking property protection in light of court structure and legal culture

Recent changes in the socio-economic environment and the constitutional framework have challenged the aforementioned long tradition in relation to property right practices. The 1997 East-Asian Financial Crisis (hereafter ‘the IMF Crisis’) forced the Korean government to accept a series of International Monetary Fund (hereafter ‘IMF’) recommendations regarding national economic policies. These IMF reform packages, influenced by neo-liberalism, dismantled a not-yet-fully-developed social security safety net. The government moved from securing employment according to the IMF labour policy reform programme and began to increase the flexibility of the labour market.⁸ Some Koreans responded by arguing that the state had backed away from its previous interventionist approach to redistribution. Moreover, they accused the state of inefficiency. Instead of demanding social justice, the Korean people paid more attention to liberal economic rights to ensure that the national economy remained internationally competitive. As a result of the IMF crisis, a notable number of Koreans ceased to believe in the government’s capacity for social redistribution.

This phenomenon could be understood in a social-psychological perspective. The 1997 Korean financial crisis left Korean collective memory social-psychologically traumatised. Some Koreans still dub it ‘the second national humiliation’, second only to the Japanese colonial occupation of Korea in 1910; yet others call it the ‘IMF Curse’. To Koreans, the state means more than it might to Western people who have struggled for freedom against state authorities: the Korean image of the state is that of an authoritarian and compassionate father, symbolising both authoritarian pressure on the one hand and pastoral care on the other. Thus, Koreans panicked when the authority of the state collapsed before a global threat. This experience led to another backlash in which people achieved benefits through the pursuit of their private interests, instead of pursuing communal welfare through solidarity.

It is not fair to say that this trend was a consequence only of neo-liberalism. Rather, it was associated with a movement to rethink the real constitutional meaning of property rights, which had been distorted by political and social influences. Before the 1987 Constitutional Amendment, the Korean Supreme Court had begun to undertake a constitutional review, even if in reality it was reluctant to consider political or liberal rights cases under the authoritarian government. Since the

⁸ Manuel R. Agosin, ‘Korea and Taiwan in the Financial Crisis’ in Ricardo Ffrench-Davis (ed) *Financial Crises in “Successful” Emerging Economies* (United Nations; Brookings Institution Press, 2001) pp.38-64; Judith Cherry, *Foreign Direct Investment in Post-crisis Korea: European Investors and ‘Mismatched Globalization’* (Routledge, 2007) pp.81-121; Iain Pirie, *The Korean Developmental State: From Dirigisme to Neo-liberalism* (Routledge, 2008) pp.105-95 (explaining the impact of the Korean financial crisis).

establishment of the Korean Constitutional Court by the 1987 Constitutional Amendment, this Court has played a significant role in reviewing all constitutional issues, invalidating early scepticism that it might be nothing more than a paper tiger.⁹ If a citizen argues that the exercise or non-exercise of a specific government power (except for a judicial decision) infringes on property rights, he or she can raise a constitutional complaint,¹⁰ in which the Court reviews the constitutionality of the government action in question.¹¹ Additionally, where a certain statute allegedly breaches property protection in a specific case, an ordinary court (the Supreme Court, appellate courts or district courts etc.) can request the Constitutional Court to adjudicate the constitutionality of the statute in question *ex officio* or through a motion by the claimant concerned.¹² The Korean Constitutional Court is composed of nine judges appointed by the President.¹³ However, three positions are appointed from candidates nominated by the Chief Justice of the Supreme Court. The other three Justices are appointed by the President from persons chosen by the National Assembly.¹⁴ The President of the Constitutional Court is appointed from among the Justices by the Korean President with the consent of the National Assembly.¹⁵

Although Justices are appointed by other constitutional organs, the independence and impartiality of Justices are institutionally secured because the Constitution guarantees a 6 year term of office and prevents them from participating in political parties or any other political activity.¹⁶ Therefore, Constitutional Court Judges – like the judges in an ordinary court – are under an obligation to make an independent decision according to their conscience and their interpretation of the Constitution and the statutes.¹⁷ More importantly, Korean Constitution Court Judges have been relatively sensitive to their public reputation for impartiality rather than bowing to the political interests of their appointers. When the Korean Constitutional Court was initially established just

⁹ James M. West and Doe Kyu Yoo, 'The Constitutional Court of the Republic of Korea: Transforming the Jurisprudence of the Vortex' (1992) 40(1) *American Journal of Comparative Law*; The Constitutional Court of Korea, *Twenty Years of the Constitutional Court of Korea* (The Constitutional Court of Korea, 2008) <http://www.ccourt.go.kr/home/att_file/ebook/1297404057391.pdf> accessed 15 April 2012; Tom Ginsburg, 'The Constitutional Court and the Judicialization of Korean Politics' in Andrew Harding and Penelope Nicholson (eds), *New Courts in Asia* (Routledge, 2010) (explaining the general history of the Korean Constitutional Court).

¹⁰ Korean Constitutional Court Act Article 68(1).

¹¹ The Constitution of the Republic of Korea (Korean Constitution) Article 111(1)5.

¹² Korean Constitutional Court Act Article 41(1). The party in the case can submit a constitutional complaint directly to the Constitutional Court when the ordinary court declines the motion for adjudication on the constitutionality of statutes. See *ibid* Article 68(2).

¹³ Korean Constitution Article 111(2).

¹⁴ *ibid* Article 111(3).

¹⁵ *ibid* Article 111(4).

¹⁶ *ibid* Article 112.

¹⁷ *ibid* Article 103.

after Korean democratisation, its authority and future were vulnerable to uncertain political changes, although many lay persons expected it to play an active role. Institutions similar to the current Constitutional Court had been established in the past for constitutional review purposes. However, those institutions were actually defunct because the military authorities just wanted to give an appearance of democracy to what was in reality a dictatorship. Of course, even under the current system, there is no practical way for the Constitutional Court to enforce its decisions in an extreme situation where the state organs involved *de facto* ignore the efficacy of the decision. In light of this situation, the Court has adopted a strategy to build its own authority and autonomy from party politics by meeting public demands for the protection of individual rights and political impartiality. The Korean people's perception of the Constitutional Court as a guard for their constitutional values, means that strong public support for the Constitutional Court cripples other state organs from ignoring the court's decisions.

Put differently, the Korean Constitutional Court has developed by echoing the social demands of the Korean public, rather than the formalised political influences of other state organs. Therefore, the Korean Constitutional Court has taken a more progressive stance than that avoided by the Supreme Court due to political pressure under the previous military government. For example, the Korean Constitutional Court has considered the constitutionality of the National Security Act. This Act was originally supposed to restrict anti-state actions that harm national security in favour of North Korea. However, former Korean dictators abused the National Security Act in order to suppress democratisation movement by defining all kinds of critical opinion about the government as anti-state behaviour. While the Korean ordinary courts in the pre-1987 constitutional system were silent under government pressure, the Korean Constitutional Court boldly declared conditional constitutionality. This served as a ground to restrict unconstitutional abuse of the law by holding that the Act was constitutional only on the condition that a relevant act could be interpreted in a specific way to define 'a threat to national existence and security' as 'a clear danger'.¹⁸

Also, concerning property issues, the Korean Constitutional Court reacted to public attitudes towards economic democratisation and the rediscovery of the values of constitutional rights. It proposed a total reconsideration of the constitutional understanding of property from scratch in several controversial cases, discussed below. Through such careful consideration, the Court hoped to distinguish genuine public interest from a *bogus* one. Indeed, many bureaucratic, corrupt or

¹⁸ 2 KCCR 49, 49-50, 89Hun-Ga113, April 2, 1990.

abusive restrictions on property had been justified without any democratic discussion or any elaborate doctrinal analysis. For example, the government had expropriated private land in order to build a dam or a nuclear waste disposal facility under the pretext of ‘public interest’ without any participatory involvement with residents or environmentalists. In this context, Korean constitutional lawyers should have articulated the scope of non-compensable regulation, which is constitutionally justified. The scope of this justification should be decided in the light of a balance between the individual sphere – whose communicative interactions establish a community – and the communal sphere where individuals act.¹⁹

Additionally, Korean scholars have adopted discussions or decisions by German lawyers in order to solve the doctrinal problems of Korean Constitutional clauses which correspond to relevant clauses of the German Basic Law. The reason for this is that the Korean constitutional system has borrowed many elements from Germany. During the Japanese conquest of Korea (1910-1945), Korean lawyers were more familiar with Japanese legal theory and process, because they had been trained in the Japanese legal system, which was inspired by the German system under Bismarck (1871-1890). After liberation from Japan, the German influence on advanced legal education continued because many academic researchers had studied law in Germany. For example, the property clauses in the Korean, Japanese and German legal systems are remarkably similar.²⁰ Eventually, such scholarly discussion has implicitly influenced the construction of court rulings. In this context, comparative studies – especially with German law – are often helpful to achieving a more profound understanding of the Korean legal system, because German legal theory has influenced the doctrinal development of Korean Constitutional Law.

¹⁹ Laura S. Underkuffler, *The Idea of Property: Its Meaning and Power* (Oxford University Press, 2003) pp.1-8 (explaining the tension between an individual concept and a communal concept of property protection). This tension is universal across the world. In the case of U.S. legal history, there has been a controversy within the regulatory state between legal realism, which supported the New Deal welfare state, and classical legalism, which insisted on the rule of law against government interventionism. See Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy* (Oxford University Press, 1992) pp.213-46, especially pp.30-33. This kind of dispute in the United States is related to modern liberalism, which can be understood as a reaction to the fear of totalitarianism, which destroyed individual autonomy. See Mark V. Tushnet, *Weak Courts, Strong Rights: Judicial Review and Social Welfare Rights in Comparative Constitutional Law* (Princeton University Press, 2008) pp.209-21. On the other hand, a group of theorists have sought ‘a third way’ between these two ideological directions. See Anthony Giddens, *The Third Way: The Renewal of Social Democracy* (Polity Press, 1998).

²⁰ Dai-Kwon Choi, ‘Development of Law and Legal Institutions in Korea’ in Bong Duck Chun, William Shaw and Dai-Kwon Choi (eds), *Traditional Korean Legal Attitudes* (University of California Berkeley, 1980); Chongko Choi, ‘On the Reception of Western Law in Korea’ (1981) 9 *Korean Journal of International and Comparative Law* (explaining the Korean legal background).

III. CONSTITUTIONAL FOUNDATIONS OF PROPERTY PROTECTION AND RESTRICTION

Against this social and legal background, Article 23 of the Korean Constitution prescribes property rights, as follows:

- (1) Rights of property shall be guaranteed for any citizen. Contents and limitations thereof shall be determined by statute.
- (2) Exercise of property rights shall conform to the public welfare.
- (3) Expropriation, use, or restriction of private property for public necessity and compensation therefore shall be governed by Act: *Provided*, that in such a case, just compensation shall be paid.²¹

A. *Tensions between the Rechtsstaat (legal state) and the social state*

The first sentence of Article 23(1) of the Korean Constitution prescribes that rights of property shall be guaranteed for any citizen (called ‘the guarantee clause’). However, this clause does not specify how the constitution protects property. It leaves many questions open: for example, does the constitution support an absolute property right that does not allow for any restriction? If not, how does the constitution restrict property rights and where are the limits of such restriction? Such questions could be understood in the context of the constitutional principles that dominate the whole Korean constitution.

One of the generally recognised constitutional principles is the *Rechtsstaat* (legal state). This constitutional principle requires the government to refrain from interfering with private rights. Nevertheless, there is no clear definition of the *Rechtsstaat* in Korea or Germany, because this concept has been understood differently under monarchical, democratic and socialist governments.²² In spite of such variant understandings, a general notion of the classical *Rechtsstaat*

²¹ This article is significantly similar to Article 14 of the Basic Law of the Federal Republic of Germany (*Grundgesetz für die Bundesrepublik Deutschland*, hereafter ‘the German Basic Law’) [Property—Inheritance—Expropriation]:

- (1) Property and the right of inheritance shall be guaranteed. Their content and limits shall be defined by the laws.
- (2) Property entails obligations. Its use shall also serve the public good.
- (3) Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected. In case of dispute concerning the amount of compensation, recourse may be had to the ordinary courts.

²² Konrad Hesse, *Grundzüge des Verfassungsrechts der Bundesrepublik Deutschland* (C.F. Müller Juristischer Verlag, 1999) Rn.183; Hee-Yol Kay, *Constitutional Law I* (Bagyeongsa, 2002) pp.308-09.

is that the state should protect the private sphere by prohibiting public (state) power according to a strictly formalist distinction between public and private. Therefore, this *Rechtsstaat* has developed several formal legal doctrines, such as proportionality or the separation of powers, in order to prevent the abuse of state power.²³

This traditional *Rechtsstaat* (classical rule of law) has ceased to function in the contemporary state. Ironically, excessive emphasis on private interests has destroyed the existential essence of the very individuals that the *Rechtsstaat* principle is supposed to protect. In particular, the emergence of private power has caused serious social injustice, as seen in industrial monopoly and the poor conditions of the working class. The classical *Rechtsstaat* was helpless against such private authoritarianism because the formal doctrine of the private/public distinction does not allow for any interventionist measures to correct this emerging social injustice.²⁴ Especially in contemporary society, human dignity can be harmed by economic poverty or by inequality. This is also the social background of the social state.²⁵

The idea of the social state emerged as a critical response to the classical *Rechtsstaat*; the social state originated from the concept of the *Sozialstaat* enshrined in Articles 20(1) and 28(1) of the German Basic Law.²⁶ Some scholars trace the historical origin of the *Sozialstaat* to the social legislation that was enacted in the Bismarck era, or to a medieval notion of mutual obligation between a Prince and his people.²⁷ However, the contemporary notion of the *Sozialstaat*, inspired by the German Social Democratic Party (*Sozialdemokratische Partei Deutschlands – SPD*), sprang directly from Articles 153 to 155 of the Weimar Constitution of 1919.²⁸ Even if this does not

²³ Gregory S. Alexander, *The Global Debate over Constitutional Property: Lessons for American Takings Jurisprudence* (University of Chicago Press, 2006) p.105. In this context, this classical German *Rechtsstaat* might be translated as the rule of law. However, this translation would be misleading, because the historical development of this concept includes other contexts than the rule of law (e.g. social justice as seen below).

²⁴ A similar discussion was found in American legal theory. See Morris R. Cohen, 'Property and Sovereignty' (1927) 13(1) Cornell Law Review.

²⁵ Kay (n 22) pp.324-25.

²⁶ The German Basic Law prescribes:

Article 20 [Constitutional principles—Right of resistance]

(1) The Federal Republic of Germany is a democratic and social federal state. [...]

Article 28 [Land constitutions—Autonomy of municipalities]

(1) The constitutional order in the Länder must conform to the principles of a republican, democratic and social state governed by the rule of law, within the meaning of this Basic Law. [...]

²⁷ Alexander (n 23) pp.105-06 (explaining the various historical origins of the German *Sozialstaat*).

²⁸ Peter C. Caldwell, *Popular Sovereignty and the Crisis of German Constitutional Law: The Theory & Practice of Weimar Constitutionalism* (Duke University Press, 1997) pp.76-77; Kim (n 5) pp.228-29; Mahendra P. Singh, *German Administrative Law in Common Law Perspective* (Springer, 2001) pp.18-20.

explain its detailed content, the German Constitutional Court clearly recognised the constitutional value of the social state.²⁹ The Korean Constitution likewise does not explicitly mention the principle of the social state, but the Korean Constitutional Court presumes that this principle is reflected in numerous clauses of the Korean Constitution. Furthermore, the Court held that this constitutional principle serves as a significant guideline which provides the Korean government with considerable discretion to form an economic-social system according to the Constitution's Preamble and Chapter IX, in addition to a series of social rights clauses.³⁰

Despite such a clear adoption of the concept of the social state, it seems impossible to achieve a unitary definition of this concept because it incorporates various elements, including seemingly contradictory ones.³¹ Nevertheless, it is generally accepted that the social state has a constitutional responsibility to secure the basic needs of the people.³² This is broader than the concept of a social safety net, so that the public welfare of the social state includes the elimination of poverty and prevention of intolerable social injustice in an affirmative manner.³³ Therefore, the Korean Constitutional Court defines the social state as one whose constitution incorporates the idea of social justice: this social state does not turn a blind eye to unjust social phenomena; rather it intervenes, distributes and coordinates in order to establish a just social order in all areas of the economy, society and culture. Ultimately, the state has a responsibility to create the conditions in which each citizen can enjoy liberty and lead a meaningful life.³⁴ This principle of the social state serves as a constitutional goal which all the organs of the state should pursue.

Here, the legislature has principal discretion to determine the measures which can be taken in order to implement the constitutional goals of the social state.³⁵ This is because the redistribution of social wealth should be based on public consensus.³⁶ In this context, the legislative branch could be the most appropriate institution to have the function of drawing up a social compromise regarding the adjustment of restrictions and the protection of property rights according to democratic procedures. The Korean Constitutional Court also took the same position in a case

²⁹ e.g. 1 BVerfGE 97, 105; 3 BVerfGE 377, 381.

³⁰ 14-2 KCCR 904, 909, 2002Hun-Ma52, December 18, 2002; 16-2(B) KCCR, 195, 204, 2002Hun-Ma328, October 28, 2004 (recognising the social state principle within the Korean Constitution).

³¹ Kay (n 22) p.327; Jina Cha, 'Idea and Limits of the Social State' (2007) 13(3) Constitutional Law Study p.167.

³² Alexander (n 23) p.105.

³³ *ibid* p.106.

³⁴ 14-2 KCCR 904, 909, 2002Hun-Ma52, December 18, 2002; 16-2(B) KCCR, 195, 204, 2002Hun-Ma328, October 28, 2004.

³⁵ Kay (n 22) p.336; Cha (n 31) p.173; Young-Soo Chang, *Constitutional Law* (Hongmunsa, 2007) p.226 footnote 27.

³⁶ Cha (n 31) p.173.

where the claimant argued that government benefits for disabled people did not meet the minimum living cost required by the social state. The Court held that the parliament has a constitutional discretion to establish social welfare legislation within the government budget by analysing the national socio-economic situation. The Court usually presumes that a governmental measure is constitutional unless its content is determined in a manner that is *apparently* arbitrary. Consequently, in the relevant case the Court denied the claimant's argument because the minimum living cost was not calculated in an apparently unreasonable way, given the financial capacity of the government and the national economy.³⁷

In this context, some German and Korean scholars have noted a tension between the social state principle and the *Rechtsstaat* principle.³⁸ Roughly speaking, the *Rechtsstaat* protects individual liberty in the private sphere, even at the risk of attacking communal welfare. In particular, the *Rechtsstaat* is eager to guarantee private property because it presumes that individual liberty, welfare and personality can exist only on the basis of property. Therefore, the infringement of property rights requires full compensation because any restriction upon or expropriation of property means an existential loss of individual personality. On the other hand, the social state seeks social justice even if this might endanger individual liberty. The social state imposes limits on property rights in order to reduce social inequality. Such interference with property rights leads to limited compensation because full compensation would nullify effective redistribution.³⁹

B. Social constitutional state (Sozial Rechtsstaat) as a harmonizing concept

However, this tension could be reconciled by a *Sozial Rechtsstaat* under the primacy of the idea of human dignity. The social state is restricted by a *Rechtsstaat*, which does not allow any arbitrary discretion of the legislature to restrict property under the pretext of the social state.⁴⁰ On the other hand, the principle of classical *Rechtsstaat* is limited by the values of the social state principles which mitigate the side effects of an abuse of private rights. As a result, the traditional *Rechtsstaat*, which is criticised by advocates of the social state, has been changed into a *material*

³⁷ 16-2(B) KCCR, 195, 195-96, 2002Hun-Ma328, October 28, 2004. See also 9-1 KCCR 543, 554-55, 94Hun-Ma33, May 29, 1997; 11-1 KCCR 503, 512-13, 97Hun-Ma333, April 29, 1999; 13-2 KCCR 422, 433, 2000Hun-Ma342, 27 September, 2001. See also Cheol-Su Kim, *New Theory of Constitutional Law* (Bagyeongssa, 2009) pp.796-800 (explaining various discussions over implementing social rights in Korean scholarship).

³⁸ Kay (n 22) pp.330-31.

³⁹ *ibid.*

⁴⁰ In this context, the Korean Constitutional Court held that social plans and coordination should not interfere with the essence of private property and the freedom of economic activities. See 1 KCCR 357, 373-74, 88Hun-Ga13, December 22, 1989.

Rechtsstaat, which supports substantive conditions that allow people to live with human dignity guaranteed by the constitution.⁴¹ While the material *Rechtsstaat* secures human dignity by protecting private property, it imposes a constitutional duty to restrict property in the interests of human dignity. Therefore, the *Rechtsstaat* encourages the state to adjust and coordinate the private sphere in order to end social injustice.⁴² Instead, government actions are required to match up with other constitutional principles, especially that of human dignity. Finally, the material *Rechtsstaat* could be translated into a *constitutional state*, in the sense of subordination to constitutional order. This constitutional state ultimately leads to the social state;⁴³ here, the concept of the social constitutional state (*Sozial Rechtsstaat*) emerges as a compromise between the social state and the *Rechtsstaat* under the primacy of a constitutional guarantee of human dignity.⁴⁴

To summarise, the realisation of property rights under the Korean Constitution is structured into three sections. Firstly, the legislative branch defines the scope of restrictions and protections in adjusting private and public interests according to public consensus. Secondly, the executive branch implements the agreed contents of property rights by exercising its own regulatory powers. Thirdly, the judicial branch reviews whether the actions of each branch have been made in accordance with the principles of the social constitutional state. The following sections will examine how the above-mentioned constitutional principles guide judicial interpretation of Article 23 of the Korean Constitution.

The social constitutional state principle reflected in the Korean Constitution protects property rights from the perspective of human dignity. This means that property rights can be restricted as long as such a restriction is supposed to protect human dignity through social justice. Therefore, the Korean Constitution allows the government to restrict property rights under strictly circumscribed conditions. To be specific, the Korean Constitution proposes two ways to deal with property restrictions under Article 23 of the Korean Constitution. Firstly, the government can actually restrict property rights by defining the constitutional meaning of property according to Article 23(1) and (2) of the Korean Constitution (Part IV). Secondly, the government can regulate the expropriation, use or restriction of property under certain conditions of Article 23(3) of the Korean Constitution (Part V). However, this constitutional framework has caused a vexing conundrum for Korean lawyers; how these two kinds of property restriction can be distinguished

⁴¹ Kay (n 22) pp.306-08; Alexander (n 23) p.107ff.

⁴² Ernst R Huber, 'Rechtsstaat und Sozialstaat in der modernen Industriegesellschaft' in Ernst Forsthoff (ed) *Rechtsstaatlichkeit und Sozialstaatlichkeit* (Wissenschaftliche Buchgesellschaft, 1968) p.598ff.

⁴³ Kay (n 22) p.308.

⁴⁴ Hesse (n 22) Rn.183ff, especially Rn. 207.

given that the forms of two restrictions appear to be similar but have their different standards and purposes? (Part VI)

IV. COMPENSATION-NOT-REQUIRED REGULATION UNDER THE SOCIAL OBLIGATION OF ARTICLE 23(2)

Although the first sentence of Article 23(1), i.e. the guarantee clause, (hereafter ‘Article 23(1)-1’), prescribes the existence of the institution of property, it does not offer any clear procedural and substantive guidance. The second sentence of Article 23(1) (hereafter ‘Article 23(1)-2’) and Article 23(2) prescribe that the contents and limits of property rights should be decided by the legislative authority according to the principles of the social constitutional state.⁴⁵ While Article 23(1)-2 makes it clear who has constitutional authority to decide the contents and limits of property rights, Article 23(2) prescribes a substantive guideline on what that authority should consider in its definition. To be specific, Article 23(2) imposes a duty on the legislature to design property rights in such a way that the exercise of property rights conforms to the public interest.⁴⁶ For example, there might possibly and arguably be numerous rights to the land. Here, the legislature imposes a limitation by excluding a right to use the land in an environmentally harmful way from the contents of constitutional property rights. In this excluded scope, the constitution recognises the governmental power to restrict or prevent environmentally harmful use of land. Finally, Articles 23(1)-2 and 23(2) order the legislature to define the contents and limits of property rights in a way that secures the following situation: even if citizens fully exercise their property rights that the legislature defines in advance, the effect of this exercise cannot be against the public interest. In this context, defining the content and limits of property rights and recognising regulatory power to restrict property rights are two sides of the same coin. Therefore, the German and Korean doctrines are discussed in the second sentence of Articles 23(1) and 23(2) together in the same context of the so-called *content-and-limit clause*.⁴⁷

⁴⁵ 10-2 KCCR 927, 944, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998; 5-2 KCCR 36, 44-45, 92Hun-Ba20, July 29, 1993; 12-1 KCCR 152, 163, 97Hun-Ba41, February 24, 2000; 20-1 KCCR 510, 516, 2005Hun-Ba43, April 24, 2008.

⁴⁶ Kuk-Won Jeong, ‘Value Decision and the Constitution and Normative Structure of Property Guarantee’ (2004) 5(1) Public Law pp.154-57.

⁴⁷ Van der Walt (n 2) pp.133-34.

A. Constitutionally protectable scope of property rights

The contents of property rights can be clarified in accordance with the principle of the social constitutional state. Therefore, these constitutional property rights are not concerned with whether the nature of a right is private or public.⁴⁸ In other words, which kinds of property rights can be constitutionally protected depends on the relationship between the property right and the constitutional principle; a closer relationship with the constitutional principle guarantees a stronger protection of the property right.

In the social constitutional state, the constitutional protection of property aims not to secure the private sphere against state power, but to generate a private sphere where people lead self-developing and self-governing lives with dignity. In this context, the German *Hamburg Flood Control* case shows that constitutional property is not related to its market value but to the ontological value of the human being.⁴⁹ In this case, Hamburg City converted all its grassland classified as ‘dyke land’ into public property in order to prevent a flood risk. In doing so, the city terminated all private rights to this property with compensation. The German Constitutional Court, validating the regulation, held that the core function of property protection in the constitution is to enable the property owner to lead a self-governing life by securing his or her economic liberty. Here, the core element that the constitution protects is not an economic value but the personhood which is reflected in the property; or the material ground on the basis of which people can lead a meaningful life.⁵⁰ This means that governmental regulatory power should be prohibited if it threatens the essence of sound human flourishing.⁵¹ To put it differently, a regulatory power such as flood control would be upheld as long as it could be supposed to secure conditions of sound human flourishing. This reasoning allows many public law entitlements such as pensions to be protected as property rights as long as these rights are essential for making the survival of claimants possible.⁵² All things considered, the meaning of constitutional property is related neither to private nor public law; and not to pure market values, but those of the constitution.⁵³

⁴⁸ Hesse (n 22) Rn.444; Hee-Yol Kay, *Constitutional Law II* (Bagyeongsa, 2002) pp.498-99. See also Chang (n 35) pp.752-753.

⁴⁹ 24 BVerfGE 367. See also Donald P. Kommers, *The Constitutional Jurisprudence of the Federal Republic of Germany* (Duke University Press, 1997) p.250ff.

⁵⁰ Alexander (n 23) pp.112-13.

⁵¹ Kommers (n 49) p.253.

⁵² David P. Currie, *The Constitution of the Federal Republic of Germany* (University of Chicago Press, 1994) pp.296-97; Alexander (n 23) pp.128-31.

⁵³ See generally Hesse (n 22) Rn.443-45; Kay (n 48) pp.497-99.

In a similar vein, the Korean Constitutional Court in the *Green Belt* case defined property rights.⁵⁴ Since 1971, the Korean government has designated and maintained development restriction areas in the name of public interest. Many Korean people blame land speculators for price hikes that have caused unrest in the stable supply of housing; for example, unregulated land speculation has made mortgages and rent unaffordable for many low-income people. In response, the Korean government has enacted very strong interventionist measures. It can designate certain areas as development restriction zones for the sake of public interests, like the prevention of reckless urban expansion, environmental protection or national security. In these zones, any construction or change in the character of land is prohibited. Whilst this Green Belt regulation has prevented any *de facto* use of land within designated areas, the government did not provide any compensation to the owners of land in such zones.⁵⁵ The Court held that property rights serve as a material foundation of a humane and decent life:

The right to property in reality forms the economic conditions that the people, as the subjects of basic rights, need for the autonomous realization of a humane livelihood. Therefore, the right to property forms the material basis for the realization of individual freedom.⁵⁶

However, the protective scope of constitutional property does not include mere benefits which are indirectly drawn from regulations. In the *Arcade Betting Machine* case, a claimant owned facilities containing an arcade betting game (coin-operated entertainment machines).⁵⁷ Initially, the business had been registered as a public amusement centre under the Amusement Place Business Law. Since early 2000, such businesses had attracted public criticism because betting machines caused social problems such as gambling addiction. Consequently, a new statute excluded such businesses from the category of amusement place businesses; instead, it required owners to apply for registration under the Sound Records, Video Products and Software Games Act. In the instant case, the authority denied the registration application of the arcade betting game by categorizing it as anti-social speculative gambling on the basis of this latter statute. The claimant argued that this

⁵⁴ 10-2 KCCR 927, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

⁵⁵ Chang-Hee Christine Bae, 'Korea's Greenbelts: Impacts and Options for Change' (1998) 7(3) Pacific Rim Law & Policy Journal; Won Woo Shuh, 'Land Use Planning and Compensation in Korea' in Tsuyohsi Kotaka and David L. Callies (eds), *Taking Land: Compulsory Purchase and Regulation of Land in Asian-Pacific Countries* (University of Hawaii Press, 2002) pp.169-94; Sung-Bae Kim, 'The Role of Government in the Redistribution of Property Rights: The Case of the Korean Greenbelt' (2004) 9(1) International Review of Public Administration (providing more information on the general social background to the Korean Greenbelt policy).

⁵⁶ 10-2 KCCR 927, 945, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

⁵⁷ 14-2 KCCR 29, 99Hun-Ma574, July 18, 2002.

regulatory change had interfered with their property right to gain the profit that could have been expected under the previous law. In this case, the Court held that the constitutionally protectable scope of the property right does not include profits that were indirectly given through a legal order. Likewise, in the *Failure to Administer Medical Specialist Certification Exam* case,⁵⁸ the Korean Medical Service Act and the Medical Specialist Training and Certification Rules did not provide the procedure for a Dental Specialist Certification Exam. In terms of career development, therefore, dentists were discriminated against, as compared to other medical personnel, like doctors, who could gain additional national medical specialist certification after their qualification as general practitioners. As a result, all dentists were categorized only as general practitioners, occasioning the problem that government-employed dentists would be paid less than other specialist doctors as the government is allowed to pay additional benefits only to the specialist doctors. The claimant in that case argued that the failure to provide for a medical specialist certification exam was an unconstitutional interference with their property rights. This argument was founded on the ground that such an omission of administrative action could harm a dentist's future chances of gaining the additional salary that would be paid if there were to be a national dental specialist qualification. Ultimately, the Korean Constitutional Court, in the *Arcade Betting Machine* case and *Administer Medical Specialist Certification Exam* case, held that constitutionally protected property rights do not include 'mere profit, a simple chance to gain profit, or factual or legal settings that are related to commercial enterprise'.⁵⁹ The Court does not consider the relevant arguable interest or loss as the protectable scope of property right if it is not directly related to the property itself, but only to benefits which come indirectly from the regulatory settings.

In addition, the *Green Belt* ruling made clear that future profits expected from existing property rights do not constitute a protectable property right. Here, one of the claimants' arguments in attacking the statute was that the designation of a restriction zone would have a negative influence on either the land price or opportunities to develop the land in the future. Thus, the property owners argued that foreclosure of such reasonably expected future benefits could constitute an unconstitutional property restriction or expropriation. However, the Korean Constitutional Court understood that

The expectation that someone could use his or her land for construction or development in the future or take advantage of the increase in the land price does not belong in principle to

⁵⁸ 10-2 KCCR 283, 96Hun-Ma246, July 16, 1998.

⁵⁹ *ibid* 309-10; 14-2 KCCR 29, 44, 99Hun-Ma574, July 18, 2002. See also 8-2 KCCR 90, 103, 95Hun-Ba36 August 29, 1996; 9-2 KCCR 651, 664, 97Hun-Ba10 November 27, 1997.

the protected extent of the right to property.⁶⁰

Further, the Court justified such ‘elimination of development opportunities and the resulting decrease in the land price or the relative slowing of the price increase’ on the ground of the constitutional social obligation of Article 23(2).⁶¹

B. Social obligation as a limitation on property protection

Property rights should be constituted in accordance with the doctrine of social obligation, which is considered a concretisation of the social constitutional state.⁶² Article 23(2) imposes a social obligation (*Sozialbindung*) on the exercise of property rights by prescribing that ‘the exercise of property rights shall conform to the public welfare’. The Korean Constitutional Court held that this social obligation is not a mere ethical duty but also a constitutional one, which is defined as a specific obligation in the form of legislative statute.⁶³ The Court understands that the social obligation represents a minimum of self-sacrifice or self-concession, not only to guarantee the core of private property institutions, but also to prevent the counter-productive effects caused by the absolute protection of property.⁶⁴ This doctrine of social obligation imposes a constitutional duty on both the individual and the government: while the property holder is obliged to serve communal welfare, the legislature has a constitutional responsibility to force the individual to accept this obligation by passing legislation.⁶⁵ This goes beyond the public nuisance doctrine of common law where the property holder does not have any right to cause public harm and the government has a police power to prevent public harm. The concept of social obligation includes not only preventing affirmative and direct harm but also protecting living conditions against the possible adverse effects of the abuse of property rights.⁶⁶ Its substantive content could be derived from the social

⁶⁰ 10-2 KCCR 927, 928, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

⁶¹ *ibid.*

⁶² Volkmar Götz and Hasso Hofmann, ‘Grundpflichten als verfassungsrechtliche Dimension’ *Veröffentlichungen der Vereinigung der Deutschen Staatsrechtslehrer (VVDStRL); Heft 41* (W. de Gruyter, 1983 1983) p.30ff.; Brun-Otto Bryde, ‘Art. 14’ in Ingo von Münch (ed) *Grundgesetz-Kommentar* (Beck, 1985) pp.664-665; Kim (n 5) p.227; Jeong (n 46) pp.157-60; Kuk Won Jeong, ‘Social Obligation of Ground Rights’ (2005) 11(3) *Constitutional Law Study*; Hun-Hwan Ko, ‘Legal Theory on the Limitations of Social Restriction to Land property Right’ (2006) 24 *Law Review* pp.61-66.

⁶³ 1 KCCR 357, 371, 88Hun-Ga13, December 22, 1989. See also Kay (n 48) pp.512-13.

⁶⁴ 1 KCCR 357, 370, 88Hun-Ga13, December 22, 1989.

⁶⁵ Alexander (n 23) pp.132-33; Ko (n 62) pp.64-66.

⁶⁶ Currie (n 52) p.295; Gregory S. Alexander, ‘Constitutionalising Property: Two Experiences, Two Dilemmas’ in Janet McLean (ed) *Property and the Constitution* (Hart, 1999) pp.94-95; Alexander (n 23) p.132; Alexander argues that a similar doctrine to that of social obligation can be found in U.S. property law. See Gregory S. Alexander, ‘The Social-Obligation Norm in American Property Law’ (2009) 94(4) *Cornell Law Review*.

constitutional state principle that is enshrined in the Korean Constitution's chapter on social rights and the economy. For example, the Court recognized legislative discretion to improve the residential environment in a densely populated district under the social obligation doctrine.⁶⁷ Here, the Court found the constitutional legitimacy of this social obligation doctrine by referring to Article 122 of the Korean Constitution's chapter on the economy.⁶⁸ Also, in the *Green Belt* case, the Court cited Article 122 in order to define the public interest that is protected by the Green Belt policy.⁶⁹ In this case, a separate opinion (Judge Lee, Young-Mo) added Article 35's environmental right to the original reasoning in order to explain the social obligation doctrine.⁷⁰

C. Proportionality between the communal social obligation and individual property protection

The protectable scope of a property right begins when the social obligation doctrine, in which the government's regulatory power prevails over the private interest, is exhausted. In other words, the meaning of property rights should be based on a balance between the private interest and the public interest. Here, this dynamic of the content and limits of a property right raises the question: where is the line between a protectable right and a right that can be restricted according to social obligations to be drawn? This is relevant to the constitutionality of certain property regulations.

In order to address this issue, the Korean Constitutional Court has employed the proportionality test, which reviews the balance between the public and private interest.⁷¹ In fact, proportionality, which originated from Article 37(2) of the Korean Constitution, is considered to be

⁶⁷ 13-1 KCCR 129, 129-30, 99Hun-Ma636, January 18, 2001.

⁶⁸ *ibid* 137. The Korean Constitution Article 122:

The state may impose, under the conditions as prescribed by Act, restrictions or obligations necessary for the efficient and balanced utilization, development and preservation of the land of the nation that is the basis for the productive activities and daily lives of all citizens.

⁶⁹ 10-2 KCCR 927, 946, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

⁷⁰ *ibid* 969. The Korean Constitution, Article 35:

- (1) All citizens shall have the right to a healthy and pleasant environment. The state and all its citizens shall endeavor to protect the environment.
- (2) The substance of the environmental right shall be determined by Act.
- (3) The State shall endeavor to ensure comfortable housing for all its citizens through housing development policies and the like.

⁷¹ 2 KCCR 245, 260, 89Hun-Ga95, September 3, 1990; 4 KCCR 853, 878-79, 92Hun-Ga8, December 24, 1992; 20-2 KCCR 727, 740-44, 2003Hun-Ba10, October 30, 2008; 18-2 KCCR 32, 47-50, 2003Hun-Ba18, July 27, 2006.

one of the constitutional principles that dominate constitutional rights issues.⁷² Generally speaking, this proportionality test consists of three steps. First, a government measure should have a legitimate constitutional purpose. Second, the government should take the least intrusive measure to achieve that constitutional purpose. Therefore, the Court will strike down a measure when there is an alternative that would interfere less with property.⁷³ Third, the private interest that is aggrieved by the government measure should be in a rational relation with the public benefit that is achieved by that measure.⁷⁴ Usually, the Court is relatively generous with the first and second steps of the proportionality test. Indeed, those factors are related to the government's ability to anticipate the consequences of property restrictions under changeable social conditions.⁷⁵ Therefore, excessively strict requirements concerning the first and the second tests run the risk of shrinking legislative power due to the limited capacity of the government to foresee future situations. In this respect, the Korean Constitutional Court respects legislative discretion regarding the first and the second tests unless the government action clearly arbitrarily or malignantly intends to neglect those requirements.⁷⁶

Consequently, the Court has a tendency to focus on the third test, using the 'sliding scale approach'⁷⁷ according to a hierarchy of property rights. Here, the social function of property is an important standard by which to balance social obligations with private interests. This can be found in Germany's *Small Garden* case, where a statute imposed a severe limitation on the right of a landowner to terminate a lease contract.⁷⁸ The German Constitutional Court analysed the change in the public purpose of small gardens in German society. Initially, a large landowner had leased a small garden for people to use as a means of making a living. Therefore, the small garden had served an important financial purpose for the public. There was a social need that protected the lease contract against an arbitrary termination by its owners.⁷⁹ However, as the economic and

⁷² Korean Constitution Article 37 (2):

The freedoms and rights of citizens may be restricted by an Act only when necessary for national security, the maintenance of law and order or for public welfare. Even when such a restriction is imposed, no essential aspect of the freedom or right shall be violated.

⁷³ 10-1 KCCR 541, 555-58, 96Hun-Ga5, May 28, 1998; 14-2 KCCR 882, 888, 2001Hun-Ma370, December 18, 2002.

⁷⁴ Kay (n 48) pp.139-42; Alexander (n 23) p.134ff.

⁷⁵ Kay (n 48) p.139.

⁷⁶ *ibid* pp.140-41. See also 10-2 KCCR 621, 631, 97Hun-Ma345, October 29, 1998.

⁷⁷ Alexander (n 23) p.138.

⁷⁸ 52 BVerfGE 1. See also Alexander (n 23) pp.136-37.

⁷⁹ This logic helped the Court to uphold the right of a tenant on rented land; therefore, the tenant has a constitutionally protectable property right that is distinguishable from the landlord's private legal ownership. See 89 BVerfGE 1. See also Kommers (n 49) p.255.

social structure of Germany changed, such small gardens have become less relevant to public welfare because they have begun to be used for commercial or industrial purposes. Therefore, stronger protections for land owners should prevail over the justification for the legislative power to regulate the contract for the lessee.⁸⁰ Finally, the Court found that the property holder's private right can be respected only to the extent that 'the general public interest does not take priority'.⁸¹ Conversely, greater recognition of the social significance that is inherent in the property leads to less protection for the private owner. Therefore, the German Constitutional Court upheld the Federal Codetermination Act of 1976, which secured worker participation in the boards of directors of large firms (*Codetermination Case*).⁸² Here, the Court recognised the public implications of the role of large firms in constitutional and economic life. Further, it held that such social relevance of property imposed a greater social obligation on the plaintiff, and therefore denied the argument that labour participation interfered with private property.⁸³

Similarly, the Korean Constitutional Court, in the *Green Belt* case, considered the social implications of property when imposing limitations on the social obligation doctrine:

The permitted scope of restriction on the right to property depends on the meaning that the object of that right holds for its subjects individually, and also for the society as a whole. The more socially bound the object is and the more important its function is, the more broadly legislative restriction is permitted. In other words, if the use or disposal of a specific property right does not remain in the domain of the owner's personal life but influences the lives of many, the legislature has a broader authority to regulate that individual's property right for the sake of the interest of the community.⁸⁴

Therefore, the court articulated the important social function of the land in the Korean socio-economic setting:

The land cannot be produced or substituted and has a limited supply: the disposable land is in an absolute shortage in comparison to the population. All people depend for their production or living upon reasonable use of the land. Its social function and national economic implications require that the right to landownership be treated differently from

⁸⁰ Alexander (n 23) p.136.

⁸¹ Currie (n 52) p.298.

⁸² 50 BVerfGE 290. See also Kommers (n 49) pp.267-74.

⁸³ Alexander (n 23) pp.137-38.

⁸⁴ 10-2 KCCR 927, 945, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998. See also 20-1 KCCR 510, 516-517, 2005Hun-Ba43, April 24, 2008.

other property rights and have built into it the stronger element of public interest.⁸⁵

To summarize, each property must be protected or restricted according to the relevance of its social function. Therefore, the constitution cannot freeze the meaning of property and the degree of property protection because the social function of property changes over time. In fact, many things that had not been considered property in the past are now recognised as constitutionally protectable property.⁸⁶ All things considered, the balancing point of the proportionality principle might be decided through a case-by-case approach in the changeable social context in which the relevant property right is established. The Korean Constitutional Court articulates the detailed contents of the proportionality test in a property right case by using the term ‘expropriation-like effect’ as will be seen in the following section.

D. Expropriation-like effect as a standard of the proportionality test

Despite this clear recognition of social obligation, the Korean Constitutional Court has also articulated an undeniable limitation on the imposition of social obligations in the *Green Belt* case. As seen above, less public-related kinds of property could be restricted more easily than others. However, the legislature cannot nullify property in its entirety because it is impossible to find a constitutional property that has no relation to human self-development or self-governance. Under no circumstances can the government encroach upon the minimal and irreducible essence of a right. In a pre-*Green Belt* case,⁸⁷ the claimant made a constitutional complaint against a regulation that allowed the government to have the authority to permit a land transaction. According to this legislation, the government could restrict or prevent certain kinds of land transactions in a given district in order to curb speculative land transactions. Here, the Court held that a property restriction encroaches unconstitutionally on the essence of a constitutional right if the result of the interference creates a situation where the property right is nullified and the content of private property is emptied to the extent that the original purpose of the property cannot ultimately be achieved.⁸⁸ However, the Court held that the relevant regulation did not constitute an unconstitutional abuse of regulatory power because it did not deprive the property owner of all possible use of the land; the property holder still had a disposable and controllable share in the property right.

⁸⁵ 10-2 KCCR 927, 946, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998. See also 1 KCCR 357, 371-373, 88Hun-Ga13, December 22, 1989.

⁸⁶ Chang (n 35) pp.753-55.

⁸⁷ 1 KCCR 357, 88Hun-Ga13, December 22, 1989.

⁸⁸ *ibid* 373-74.

In the subsequent *Green Belt* case, the Korean Constitutional Court recognised the unconstitutionality of certain parts of the Green Belt policy by reference to this ruling that the government should not remove all possibilities for the meaningful use of property. The Court held that the Green Belt policy itself was constitutional in the context of the social obligation doctrine. Nevertheless, it found that there could be an exceptional unconstitutional situation where the owner of a certain kind of land was forced to endure more ‘special property loss’ than other land owners in the Green Belt zone.⁸⁹ To be specific, the bare building lots of the claimants in that case could not have been used in any other designated legal way that was consistent with the Green Belt policy (e.g. for an agricultural purpose). On this point, the Court ruled that the state’s public policy violated the proportionality between the public interest promoted by the restriction and the private interests enjoyed by the property owner. The Constitutional Court held:

[I]f the zone designation forecloses the pre-existing uses or all possible uses, effectively blocking all the venues to use or profit from the land, the ownership remains only in name and becomes vacuous. Such a result exceeds the social limit that the landowners must accept.⁹⁰

This reasoning did not clearly articulate the meaning of ‘exceptionally severe interference’ with the property. In this context, the *Long-term Non-performance of Urban Planning* case⁹¹ proposed the term ‘expropriation-like effect’ to describe this unconstitutionally disproportionate situation. In this case, the public authority designated the plaintiff’s properties as school sites according to urban planning. The relevant legislation prescribed that compensation would be made when the project started. However, the public authority delayed the project for more than 15 years. The plaintiff argued that this government action caused an intolerable interference with the individual property. The Court held that the imposition of such a severe burden provoked a governmental obligation to provide compensation because the proportionality principle had been breached by causing an ‘expropriation-like effect’.⁹² This ‘expropriation-like effect’ occurs when the governmental action eliminates all possibilities of the private use of land.⁹³ This term has subsequently been used in other property rights cases.⁹⁴

⁸⁹ 10-2 KCCR 927, 954-56, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

⁹⁰ *ibid* 952.

⁹¹ 11-2 KCCR 383, 97Hun-Ba26, October 21, 1999.

⁹² *ibid* 408.

⁹³ *ibid* 408-09.

⁹⁴ 16-2(B) KCCR 247, 261, 2003 Hun-Ga16, November 25, 2004. In particular, the Court has actively referred to this reasoning in order to strike down property regulations as unconstitutional. See 15-1 KCCR 371,

E. Compensation-like measure as a remedy

Traditionally, the remedy for a breach of a contents-and-limits clause has principally been the restitution of the status quo ante or the disallowance of the intended measure.⁹⁵ The reason for this is that the property protection of Articles 23(1) and (2) is oriented towards securing the *existence* of the property, rather than reimbursing its value retroactively after an interference.⁹⁶ The constitutional principle of German and Korean property law is that the loss of property cannot be replaced with equivalently valued property or money because each property has its own original, moral and personal value attached to the owner's personhood.⁹⁷ Therefore, even if such a restriction violates proportionality between the public and private interest, a remedy based on Article 23(2) does not require monetary compensation.

However, the problem is that such remedies based on a breach of Article 23(2) could not provide satisfactory measures to support an aggrieved person, especially where state action has already caused negative effects. Suppose that the government introduced a restriction on stock dealing by preventing a person from selling or buying specific shares. In an unexpected situation – for example, if there was a significant decrease in the price of a share for a short time – the mere withdrawal of the regulatory measure would not be enough for an aggrieved shareholder to be reimbursed for the *loss in property value* even if that property owner were to regain *the status quo ante of the property right*. Given complicated contemporary economic settings, the traditional remedy for a breach of Articles 23 (1)-2 and (2) may effectively be seen as locking the stable door after the horse has bolted.

Theoretically, of course, the claimant could ask for compensation in light of the state's tortious liability under Article 29(1),⁹⁸ instead of pursuing compensation under Articles 23(1) and

396-97, 99Hun-Ba110•2000Hun-Ba46, April 24, 2003; 17-2 KCCR 98, 131, 2002Hun-Ba84, September 23, 2003 (regarding the separate opinion of Justice Kwon, Seong).

⁹⁵ This is roughly equivalent to the prerogative order of *certiorari*, a quashing order in English administrative law. See Martina Künncke, *Tradition and Change in Administrative Law: An Anglo-German Comparison* (Springer, 2007) pp.11-18 (regarding the historical and theoretical understanding of *certiorari* and quashing orders).

⁹⁶ Kay (n 48) p.505.

⁹⁷ On this ground, the plaintiff in the German *Hamburg Food Control* case was able to challenge the breach of Article 14 despite the provision of just compensation. Comparatively speaking, the U.S. Supreme Court seems to consider property as a commercial commodity, which can be replaced in the market without any social context or personhood. In other words, the U.S. concept of property is based on the idea of a commodity, which can be exchanged in the market. See Alexander (n 23) pp.112-13.

⁹⁸ The Korean Constitution Article 29 (1):

In case a person has sustained damages by an unlawful act committed by a public official in the course of official duties, he may claim just compensation from the State or public

(2). Tortious liability under Article 29(1) derives from the illegality of a government action; to take an example, an aggrieved citizen could ask for tortious compensation for the illegal exercise of police powers when a police officer has abused his powers by neglecting demonstration control guidelines when bringing a protest under control. This liability under Article 29 is established on the basis of the illegality of the official's action, rather than on the grounds of an interference with the property right itself.

However, to date there has been no case where the plaintiff has requested compensation for property interference through a claim under Article 29. To constitute state tortious liability, Article 29(1) of the Korean Constitution requires the claimant to prove a wilful or negligent breach of duty by an individual officer (i.e. the officer's fault).⁹⁹ Practically, it is extremely difficult – indeed, impossible – to establish state tortious liability for losses caused by unconstitutional legislation itself or by administrative action which has been taken according to unconstitutional law.

Firstly, the claimant might not be able to ask for compensation for loss or grievance caused by the unconstitutional legislative statute. Theoretically, the claimant could raise a claim by establishing the liability of an individual lawmaker, as long as members of parliament can be considered to be 'public officials' and the *making* of an unconstitutional law is interpreted as an illegal *act*. The claimant could therefore argue that legislators neglected their duty of due care to abide by the constitution. However, it is not easy to establish the detailed fault (e.g. negligence or willfulness) of individual lawmakers in the lawmaking process. In particular, it seems unclear as to whether legal liability could be distinguished from the political responsibility of the parliament. In relation to this, the fundamental question is how one can clearly prove the tortious fault of individual lawmakers. The academic community is very sceptical about recognizing tortious fault on the part of lawmakers because the expansion of liability in this manner could shrink legislative discretion.¹⁰⁰

Secondly, an aggrieved claimant could ask for compensation by challenging an administrative act taken by a public official in accordance with unconstitutional legislation. However, Article 47(2) of the Constitutional Court Act recognises the validity of administrative acts which have been taken before a constitutional decision on the administrative acts in

organisations under the conditions as prescribed by the Act. In this case, the public official concerned shall not be immune from liabilities.

⁹⁹ Kim (n 37) p.937; Jee-Tae Ryu and Jong-Soo Park, *Administrative Law* (Parkyoungsa, 2009) pp.461-62.

¹⁰⁰ Kim (n 37) p.936; Ryu and Park (n 99) pp.458-59.

question.¹⁰¹ In other words, it might be unreasonable to establish the tortious faults of an officer who merely followed an unconstitutional regulation, which was presumed to be a valid law before any constitutional review was involved.

In order to deal with these practical problems, the Korean Constitutional Court imposed a legislative obligation to make compensation. Here, the Korean Constitutional Court held:

The legislature, in order to make the instant provisions constitutional, must enact compensation provisions to address the exceptional situation and alleviate the cruel burden exceeding the permitted scope. Such compensation provisions are necessary provisions when the legislature forms the content of the right to property and regulates it for the sake of the public interest in accordance with Articles 23 (1) and (2) of the Constitution.¹⁰²

In the subsequent cases, this is called a ‘compensation-like measure’ to restore proportionality in cases of severe interference with property.¹⁰³

However, the legislative branch has the prime authority to implement that constitutional duty. Therefore, the claimant cannot ask for individual compensation except for the stopping of the government action in question until the government has made amendment by means of compensation-like measures. Clearly, the Court does not ask the government to directly and individually compensate claimants, but to make an amendment while ordering that ongoing government action be stopped. Therefore, individual compensation can be provided only according to the new law; in other words, a property owner cannot gain any compensation if the government decides to give up the restriction policy. Hypothetically, the government would not take any further step towards proportionality if it thought that spending on compensation or compensation-like measures would nullify all the benefits of a public policy or be beyond its financial capacity. In addition, the specific means of implementing compensation-like measures should be decided by the legislature. In other words, the parliament can define the nature of such compensation, which may be either monetary or non-monetary as long as it can cure the unconstitutionality. Moreover, the extent of such compensation does not need to exceed the level that is sufficient to restore the

¹⁰¹ The Korean Constitution, Article 47 (Effect of a Decision of Unconstitutionality) (2):

Any statute or provision thereof decided as unconstitutional shall lose its effect from the day on which the decision is made: *Provided*, That the statutes or provisions thereof relating to criminal penalties shall lose their effect retroactively.

¹⁰² 10-2 KCCR 927, 956-57, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

¹⁰³ 15-1 KCCR 371, 371-76, 396-97, 99Hun-Ba110•2000Hun-Ba46, April 24, 2003.

constitutionality of Articles 23(1)-2 and (2) by mitigating the disproportionate effect.¹⁰⁴ In the *Green Belt* and *Long-term Non-performance of Urban Planning* cases, the Constitutional Court also held that the legislature has the principal discretion to decide the method of compensation.¹⁰⁵ The Court held:

The means to restore the proportionality between the public interest and the infringement on the right to property does not have to be monetary compensation. The legislature may release the land from the zone designation, grant the landowners the right to request the state to purchase the land, or use other means to alleviate the loss. The legislature has a broad freedom of formation in choosing the appropriate ‘means’ to accomplish the ‘end’ of adjusting or alleviating the cruel burden.¹⁰⁶

After the *Green Belt* decision, the legislature established an Act on Special Measures for the Designation and Management of Areas of Restricted Development. This act grants landowners the right to request that the state purchase the land if the designation of land as Green Belt zone has reduced the usefulness of the property or has removed any meaningful possibility of using it or of gaining profits from its original purpose. In addition, the Minister of Construction and Transportation can purchase land within a Green Belt zone through negotiations with the relevant land owner when this is deemed necessary for the purposes of Green Belt policy. The Court later held that this Green Belt regulation was constitutional because the Act on Special Measures for the Designation and Management of Areas of Restricted Development includes proper compensation which achieves proportionality with the object of the measure.¹⁰⁷

V. COMPENSATION-REQUIRED PUBLIC RESTRICTION UNDER ARTICLE 23(3)

As discussed above, the Korean Constitutional Court has made three points clear: i) the government can establish non-compensated regulation based on social obligations under Article 23(2); ii) as long as the regulation does not cause expropriation-like effects or the government provides compensation-like measures; iii) the government has in principle discretion to decide the method of compensation-like measures as long as these are deemed enough to cure the disproportionate situation in which the expropriation-like effect occurs.

¹⁰⁴ Kay (n 48) p.528 footnote 148; Alexander (n 23) p.121.

¹⁰⁵ 10-2 KCCR 927, 929-30, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

¹⁰⁶ *ibid* 956-57.

¹⁰⁷ 16-1 KCCR 202, 226-27, 2001Hun-Ba80•84•102•10, 2002Hun-Ba26, February 26, 2004; 18-1(A) KCCR 1, 1-2, 2005Hun-Ba18, January 26, 2006.

However, the Korean government can make use of another type of property restriction (public restriction) which belongs to the concept of public interferences under Article 23(3). Of course, usually interference with property should occur within the framework of the social obligation doctrine of Article 23(2). However, there are exceptional situations in which the government is required to interfere with property beyond this social obligation doctrine. In order to address such unusual situations, Article 23(3) of the Korean Constitution permits public interference. The typical situation is one of expropriation; physical transfer of title is not allowed under Article 23(2) even on the grounds of some desperate requirement of human dignity. However, the government inevitably has to take over private property in exceptional situations, namely for reasons of public necessity. For example, the army may have to *temporarily use* people's cars in cases of national emergency; or the local authority has to *own* private land in order to build a new highway or launch an urban redevelopment project. Here, Article 23(3) defines such government action as public interference, consisting of three kinds of property interference: namely, 'expropriation, use or restriction of private property'. To be specific, public expropriation consists of government actions that are taken to deprive a citizen of some part or the entirety of her or his property with the physical transfer of title. Next, public use relates to an action that uses a citizen's property temporarily and authoritatively without title transfer. Lastly, public restriction is defined as a government action taken to restrict a citizen from using or profiting from her or his property without any transfer of title. Among these three types of public interference, public restriction is very similar to regulation based on social obligation under Article 23(2), because neither action deprives the citizen of her or his property title physically. However, public restriction in the form of public interference under Article 23(3) requires the satisfaction of different conditions (public necessity and just compensation) from the property restriction under Article 23(2).

Public interference is allowed only on condition of public necessity and just compensation. The scope of public necessity is articulated by proportionality between public and private interest according to Article 37(2).¹⁰⁸ However, this balancing point of proportionality is different from the one found in Article 23(2). In fact, constitutional public interference has a compensation provision to reimburse the property loss; unlike restriction under Article 23(2), which allows only for a compensation-like measure. Therefore, public necessity is generally considered more broadly than the 'public welfare' of Article 23(2) in the sense that the restriction of Article 23(3) is an interference that cannot be legitimated by the social obligation doctrine.¹⁰⁹ The *potential* illegality

¹⁰⁸ 10-1 KCCR 226, 244-45, 93Hun-Ba12, March 26, 1998.

¹⁰⁹ Chang (n 35) pp.761-62.

of this interference can only be cured by just compensation. In this case, the proportionality test of public interference considers the amount of compensation, the degree of interference and public necessity (which is broader than social obligation), whereas the proportionality test of Article 23(2) considers private interest and social obligation (and compensation-like measures in certain situations). Therefore, more compensation for public interference could justify broader reasons (public necessity) for the public interference. This doctrine of public necessity could be similar to the understanding of public use found in U.S. constitutional doctrine, where a taking could be allowed when the governmental measure is ‘rationally related to a conceivable public purpose’.¹¹⁰ However, Currie argues that the concept of the ‘public good’ found in Article 14(3) of the German Basic Law (the ‘public necessity’ of the Korean Constitution, Article 23(3)) is broader than the public use allowed by the U.S. Supreme Court, in the sense that the German doctrine upheld taking for private benefit which promoted social welfare. The German Court allowed a government action taken on behalf of a refugee settlement,¹¹¹ a transmission of private power,¹¹² a test track for a private automaker,¹¹³ and a private cable car for public recreation,¹¹⁴ as long as it recognised the relevance of the public interest.¹¹⁵ Conversely, the German Constitutional Court does not allow for public interference merely for governmental financial enlargement unrelated to social welfare.¹¹⁶

Although all three types of public interference require just compensation, there is nevertheless controversy over the meaning of just compensation. Some commentators argue that just compensation means the full payment of the objective full market value of the property.¹¹⁷ Others argue that just compensation means ‘an equitable balance’ between public and private interests, rather than the full market value, and this is decided by the social state principle.¹¹⁸ In exceptional cases, full compensation would not be appropriate. For example, suppose the government expropriated a parcel of land for a public project and that this piece of land had been the only source of income for a 70-year old farmer, with no other means of earning a livelihood. It may be impossible or too expensive for this person to gain a relevant comparable piece of land. If so, just compensation may require more than the full market value because it should cover the cost

¹¹⁰ *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 231 (1984). See also *Berman v. Parker*, 348 U.S. 26 (1954). This reasoning is followed by *Kelo v. City of New London*, 545 U.S. 469 (2005).

¹¹¹ 46 BVerfGE 268, 288-89.

¹¹² 66 BVerfGE 248, 257-59.

¹¹³ 74 BVerfGE 264.

¹¹⁴ 56 BVerfGE 249.

¹¹⁵ See generally Currie (n 52) p.292.

¹¹⁶ Kay (n 48) p.517.

¹¹⁷ Jeong (n 46) p.163; Chang (n 35) pp.764-65; Ryu and Park (n 99) pp.523-24.

¹¹⁸ Kay (n 48) pp.528-29; Alexander (n 23) p.115.

of living conditions for that farmer in accordance with the constitutional meaning of property in Article 23(1), which is based on the social state principle. Conversely, compensation could be less than the market value, if the high cost of full market compensation would foreclose proceeding with the public project, which could be justified by the social state principle. All things considered, more compensation would be paid for the socially weaker and less for socially stronger groups.¹¹⁹

Contrary to the doctrine of equitable balance, the Korean Constitutional Court has consistently held that only full compensation of the objective value of property is constitutional. However, full compensation does not cover the profits or losses derived indirectly from the property or caused by governmental action.¹²⁰ Here, the problem is that there is no clear guideline to recognise the protectable profits and losses which should be considered in calculating the value of compensation. As a matter of fact, one might have difficulties in calculating the precise value because of the exceptional nature of property such as land. For example, suppose that the government made public a redevelopment plan, in which the authority had to consider compensation based on the market value before the redevelopment announcement. However, there is a tendency for the price of relevant property and its neighbouring land to increase after the government's announcement of the plan because the project is expected to trigger the subsequent new planning on the adjacent land or boost the local economy. Moreover, this temporal price difference could encourage speculators to purchase the land. Such an extraordinary increase between the previous and current price runs the risk of rendering the government project much more difficult or even impossible. In addition, this situation might cause unjust social redistribution because the public budget could go to land speculators. Finally, this process runs the risk of destroying a sound land market condition and balanced land development. As a result, the Korean Public Notice of Values and Appraisal of Real Estate Act requires the Ministry of Land, Transport and Maritime Affairs to regularly publish the standard land price of 50,000 major standard lots out of a total of all 27,000,000 lots on the land register across the country. The government analyses these prices by considering many facts, such as recent land transaction records, and the relevant land owner can make an administrative suit against a decision on standard land prices. Once published, these prices serve as a standard with which the government calculates compensation in the course of carrying out land planning. Regarding this regulatory system, the Korean Constitutional Court denied a claimant's argument that this standard land price policy violates the principle of just compensation. The Court held that the standard price could be used in calculating

¹¹⁹ Kim (n 37) p.659.

¹²⁰ 7-1 KCCR 519, 519, 93Hun-Ba20, April 20, 1995; 11-2 KCCR 721, 729, 98Hun-Ba13, December 23, 1999; 13-1 KCCR 932, 938, 2000Hun-Ba31, April 26, 2000.

the full value compensation of Article 23(3) as long as this price reasonably reflects the normal market situation by excluding any expected profits or speculative surplus value from land planning.¹²¹

VI. BLURRED LINE BETWEEN COMPENSATION-NOT-REQUIRED REGULATION AND COMPENSATION-REQUIRED PUBLIC RESTRICTION

A. Discussions over the structural relation between Articles 23(2) and 23(3)

Of the three kinds of public interference provided in Article 23(3), public use and public expropriation can be easily recognized in that they require the apparent physical transfer of title – whether temporarily or permanently. However, there is no clear agreement on the proper understanding of public restriction. In particular, it is difficult to draw a clear line between the restriction of Article 23(2) and the public restriction of Article 23(3).¹²² Nevertheless, these two restrictions require different remedies. The restriction of Article 23(2) requires non-compensation or compensation-like measures which can be decided by the government. By contrast, the public restriction of Article 23(3) could be accompanied by full compensation, the amount and degree of which are not entirely within governmental discretion.

This blurred line caused doctrinal controversy in the *Green Belt* case, where the claimants argued that state policy breached Article 23(3).¹²³ Here, the formal appearance of this arguably illegal restriction without compensation based on Article 23(3) is exactly the same as a legal restriction under Article 23(2) that does not stipulate compensation. Two kinds of restrictions are similar particularly in that neither restriction entails any physical transfer of title but merely a restriction on the use of property. On the other hand, a breach of Article 23(2) requires the amendment of related laws without compensation. Therefore, to rebut the claimant's argument in this instance, the government contended that the restriction was established on the basis of social obligation under Article 23(2).¹²⁴

¹²¹ 13-1 KCCR 932, 2000Hun-Ba31, April 26, 2000.

¹²² Ko (n 62) pp.66-67; Nam-Chul Chung, 'The Differentiation of the Compensable Public Interference Subject and Non-compensable Content-and-Limits' (2010) 31 Kangwon Law Review p.87.

¹²³ 10-2 KCCR 927, 937, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998 (Complainants' Arguments).

¹²⁴ *ibid* 940-41 (Opinions of the Ministry of Construction and Transportation and the Ministry of Justice).

Against this backdrop, Korean threshold theory, influenced by the German threshold theory (*Schwellentheorie*), argues that Articles 23(2) and 23(3) are structurally connected.¹²⁵ The distinction between the restriction of Article 23(2) and the public restriction of Article 23(3) is a matter of degree. Therefore, even if the legislature were to establish the law initially according to Article 23(2), the government should give the relevant claimant compensation of the kind specified in Article 23(3) as long as the final result causes intolerable harm to a specific individual contrary to the proportionality principle.¹²⁶

Here, the threshold theory considers the ‘special sacrifice’ doctrine as an important indicator for defining public interference.¹²⁷ The existence of special sacrifice is an element that is required to distinguish public interference from other types of intrusive governmental action. The recognition of public interference depends on whether a special sacrifice on the part of a particular person is required by a government action. However, both Korean and German constitutional scholarship suffer from the difficulties of finding a substantive guideline to recognise the occurrence of special sacrifice. Initially, a traditional approach focused on the formal appearance of causing a burden; therefore, special sacrifice was recognised as occurring when it is apparent that a governmental act is intended to apply to a particular group in an unequal way. This approach originated from a method that was used by the German Empire Court (*Reichgericht*) in the Weimar era.¹²⁸ However, the legislation of a contemporary democratic state rarely targets a particular person or property. While parliament interferes with property according to *generally applicable* statute, the general application of this principle by the statute causes unequal burdens to fall on certain persons. For example, in the *Green Belt* case, the statute did not intend to discriminate against a certain group of persons in appearance and it applied equally to any person who had property in the restricted zone. However, its general application led to an unequal situation where property owners of *bare building lots* were forced to assume a greater burden than other property owners in the Green Belt zone. Finally, the previous formalist approach has changed in favour of more substantive considerations of inequality; several cases before the Federal Court of Justice of

¹²⁵ 6 BGHZ 270; 7 BGHZ 296; 10 BGHZ 255; 11 BGHZ 248; 13 BGHZ 371; 13 BGHZ 395. See also Ko (n 62) pp.67-69.

¹²⁶ This doctrine is reminiscent of the regulatory taking doctrine of the U.S. Supreme Court in that it pays attention to the severity or consequential effect of property restriction rather than the mode of taking. Here, ‘while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking’. See *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922). See also Currie (n 52) p.293; Gregory S. Alexander, ‘Property as a Fundamental Constitutional Right – the German Example’ (2002) 88(3) Cornell Law Review p.757.

¹²⁷ Ko (n 62) p.72.

¹²⁸ Kay (n 48) p.522.

Germany (*Bundesgerichtshof*, hereafter ‘the German Federal Court of Justice’) started to consider various substantive factors, such as the unequal results expected from the general application of legislation.¹²⁹ One of the most influential doctrines in this regard concentrates on the severity of the interference.¹³⁰ The occurrence of special sacrifice is upheld when the suffering caused by a government action is intolerable in the context of the social obligation doctrine, when the proper function is blocked or seriously impeded, or when the original purpose of the property is changed to a completely different one.¹³¹

Interestingly, the meaning of the special sacrifice doctrine has become increasingly similar to the effect of disproportionate government action under Article 23(2). In precisely this context, the Korean threshold theory identifies the special sacrifice of Article 23(3) with the extremely disproportionate situation of Articles 23(1) and (2); thus special sacrifice presents itself as a *threshold* where Article 23(2)’s restriction changes into that of Article 23(3).¹³² The German Federal Court of Justice’s special sacrifice doctrine and the Korean Constitutional Court’s expropriation-like effect refer to a situation where all meaningful uses of a property are blocked. Therefore, the Korean threshold theory argues that the Court should consider the *Green Belt* cases in the context of Article 23(3) because the government could render the content of a property ‘empty’ even without any actual taking.¹³³

Further, threshold theory proponents argue that an aggrieved property owner can ask for direct and individual compensation for unconstitutional public restriction without waiting for any aftermath measures such as legislative amendments.¹³⁴ Instead, the government does not need to stop ongoing measures because the provision of just compensation cures the unconstitutionality of the statute. To summarise, the property owner accepts the severe harm and instead can ask for direct compensation which would be expected if such public interference included just compensation. Therefore, an ordinary court could issue an order for the government to pay compensation calculated hypothetically by that court without any legislative participation. This feature reveals that compensation based on threshold theory has a fundamentally different nature

¹²⁹ 6 BGHZ 270, 280. See also Kim (n 5) pp.346-48; Chang (n 35) p.760.

¹³⁰ Kay (n 48) p.523.

¹³¹ See generally Kim (n 5) pp.346-54; Kay (n 48) pp.522-25.

¹³² Yeon-Joo Jeong, ‘Property Protection and Proportionality’ (2001) 29(3) Public Law pp.59-60; Yeon-Joo Jeong, ‘Green Belt and Property Protection’ (February 1999) *Kosikay* pp.142-43.

¹³³ Jeong (2001) (n 132) pp.54-61; Ha-Joong Jeong, ‘Threshold Theory and Separation Theory in System of Constitutional Property Protection’ (2003) 5 *Sugang Legal Study* pp.81-82; Kim (n 37) pp.666-67; Jeong (February 1999) (n 132) pp.141-45.

¹³⁴ Kim (n 37) pp.659-60.

from compensation-like measures in terms of the separation of powers because the threshold theory does not have any room for legislative control, *unlike the compensation-like measures*.

However, a critical problem for the threshold theory is that a court cannot find any constitutional ground for a judicial order of direct compensation for particular individuals. If one were to apply the threshold theory to the situation in the *Green Belt* case, an ordinary court could not order any compensation, even if it was suspicious about the policy's constitutionality. The only choice open to the ordinary court would be to request that the Constitutional Court adjudicate on the constitutionality of the statute according to the Korean Constitutional Court Act, Article 41. Here, suppose that the Constitutional Court were to strike down the Green Belt policy on the grounds of a violation of Article 23(3), according to the special sacrifice doctrine of the threshold theory. That decision would prevent the court and the executive from relying on the unconstitutional statute.¹³⁵ Therefore, the government would have to stop the ongoing measure and make amendments in order to resume the public interference in accordance with the constitution. Even if the court can order the withdrawal of the relevant government action, it, unlike the German courts, does not have the power to order that any direct compensation be paid to plaintiffs as a remedy to unconstitutional acts; the plaintiff will have to wait for the legislative amendment to include a just compensation provision. In Germany, the Federal Court of Justice (the ordinary non-constitutional court) can order the government to pay compensation directly to the plaintiff by relying on customary law and case law accumulated over a long time, in accordance with Sections 74 and 75 of the Introduction to the Prussian General Land Law of 1794 (*Einleitung zum Preußischen Allgemeinen Landrecht*)¹³⁶ However, in Korea there is no such body of customary law or case law upon which the Court might rely in order to allow for individual and direct remedy.¹³⁷

Despite this formal weakness of the threshold theory, one cannot ignore its practical benefits in terms of providing an efficient remedy. Indeed, an aggrieved property owner usually prefers to receive direct and immediate compensation rather than waiting for a slow legislative process to be

¹³⁵ Korean Constitutional Court Act, Article 47 (Effect of Decision of Unconstitutionality):

- (1) Any decision that statutes are unconstitutional shall bind the ordinary courts, other state agencies and local governments;
- (2) Any statute or provision thereof decided as unconstitutional shall lose its effect from the day on which the decision is made: Provided, that the statutes or provisions thereof relating to criminal penalties shall lose their effect retroactively.

¹³⁶ Fritz Ossenbühl, *Staatshaftungsrecht* (C.H. Beck, 1983) p.117ff.; Jochen Rozek, *Die Unterscheidung von Eigentumsbindung und Enteignung: eine Bestandsaufnahme zur dogmatischen Struktur des Art. 14 GG nach 15 Jahren "Naßauskiesung"* (Mohr Siebeck, 1998) p.74.

¹³⁷ Kim (n 5) p.390; Ryu and Park (n 99) pp.516-18; Chung (n 122) pp.100-01.

completed, particularly where a property interference has already caused an excessively severe and irretrievable result. For example, suppose that a person had shares to the value of £20,000. However, that person has suffered from an extreme loss (around £10,000) in the property value of these shares because government action has prevented him or her from selling the shares in good time before a slump in the stock market. Here, it does not matter to that person whether he or she can stop an unconstitutional action in terms of making up for loss occasioned; just like so-called ‘Monday-morning quarterbacking’. Otherwise, a property owner would be in an unstable situation until the legislature were to take a compensation-like measure or make an amendment, both of which are very vulnerable to political influence and are out of a claimant’s control. As such, a claimant would prefer immediate full compensation of the property value directly from the Court, even if that person endures the consequences of the government action.

B. Uncertain reasoning of the Korean Constitutional Court

The Korean Constitutional Court has not provided clear guidelines on the definition of public interference within the meaning of Article 23(3). In the *Green Belt* case it failed to address the plaintiff’s claim that the Green Belt policy was an unconstitutional public restriction under Article 23(3). Here, the Court held that the government action caused an unconstitutionally disproportionate effect by blocking all possible land use in the designated area. The Court’s reasoning in this regard was very similar to the threshold theory’s logic in finding special sacrifice. However, this unconstitutionality did not provide a constitutional ground for allowing direct compensation. All things considered, it seems clear that the court did not accept the threshold theory because it reviewed the statute only within the context of Articles 23(1) and (2). In consequence, the expropriation-like effect of the state action did not trigger the governmental duty of compensation under Article 23(3). Rather, the Court appeared to recognise the constitutional duty to take compensation-like measures in the context of Articles 23(1) and (2).¹³⁸

The compensation-like doctrine invented by the Korean Constitutional Court is very similar to the doctrine of equalisation based on the content-and-limit clause (*ausgleichspflichtige Inhalts- und Schrankenbestimmung*).¹³⁹ The doctrine of equalisation based on the content-and-limit clause is based on the German separation theory (*Trennungstheorie*) which presumes that the German

¹³⁸ 10-2 KCCR 927, 929, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

¹³⁹ Nam-Chul Chung, ‘The Distinction between Social Obligation of Property and Expropriation in the Comparison between the Federal Republic of Germany and Korea’ (2004) 32(3) Public Law pp.378-84.

Basic Laws 14(2) and 14(3) are structurally separated.¹⁴⁰ A series of German Constitutional Court cases stopped the previous practice of the German Federal Court of Justice of ordering compensation on the basis of unconstitutional expropriation.¹⁴¹ In the famous *Groundwater* (*Naßauskiesung*) case, the plaintiff had owned and operated a gravel pit in groundwater in accordance with the Prussian Water Act of 1931, since 1936. Later, the 1976 amendments to the Federal Water Resource Act (first enacted in 1957) allowed a public authority to refuse a permit for the use of water for the public interest, namely the prevention of environmental risk. Citing this law, the city denied the plaintiff permission to use the groundwater on the grounds of environmental danger. The aggrieved party eventually argued that that administrative act was an uncompensated expropriation.¹⁴² The German Constitutional Court rejected the plaintiff's claim by holding that Article 14(3) of the German Basic Law refers only to a physical taking of property, which is the literal meaning of 'expropriation'.¹⁴³ Therefore, the relevant administrative act in the *Groundwater* case, despite its severe effect, could not be considered to be an expropriation because permit denial does not remove any portion of the physical property.¹⁴⁴ Finally, the separation theory presumes that there is a fundamental gap between Article 14(2) and Article 14(3). Instead, the German Constitutional Court developed a doctrine of state obligation for equalisation based on the content-and-limits clause. Some German constitutional decisions admitted the state's obligation to compensate for extremely disproportionate legislative acts in the *Mandatory Specimen* case (*Pflichtexemplar*) case¹⁴⁵ and the *Monument Protection* (*Denkmalschutz*) case.¹⁴⁶ The facts of the *Monument Protection* case are similar to those of the Korean *Green Belt* case.¹⁴⁷ In the *Monument Protection* case, the plaintiff was barred from demolishing his own house, which had been designated as a historically valuable building. Here, the Court did not consider any property restriction with actual taking as leading to an expropriation claim by following the reasoning in the *Groundwater* case; it made a clear statement that a mere restriction without any actual taking is not considered to be an expropriation in the sense of Article 14(3). Nonetheless, the Court held that the

¹⁴⁰ Ha-Joong Jeong (n 133) pp.67-75; Moon-Hyun Kim, 'A Study on the Systematic Relation between "Eigentumsbindung" and "Enteignung" – Especially on Estimating Reception of "Trennungstheorie" in Korea' (2004) 32(4) Public Law pp.4-9; Ko (n 62) pp.69-70 (explaining the German separation theory).

¹⁴¹ 58 BVerfGE 300.

¹⁴² Kommers (n 49) pp.257-62.

¹⁴³ Kim (n 5) pp.338-39.

¹⁴⁴ This is confirmed by subsequent constitutional decisions. See 100 BVerfGE 226; 104 BVerfGE 1.

¹⁴⁵ 58 BVerfGE 137.

¹⁴⁶ 100 BVerfGE 226.

¹⁴⁷ In the *Mandatory Specimen Copy* case, the public authority required the publisher to deliver a sample copy for free, according to the public interest of the content-and-limit clauses. However, the plaintiff argued that such a requirement was too severe to be proportional because the publisher released a limited number of books, which are very expensive. See Kim (n 5) p.340; Kay (n 48) p.527.

content-and-limits clause imposed the governmental obligation to compensate the plaintiffs' for suffering caused by extremely disproportionate measures, which blocked any substantial possibility of using the property.¹⁴⁸ This obligation of the separation theory is not derived from Article 14(3) of the German Basic Law but from the content-and-limits clauses, namely Articles 14(1)-2 and 14(2).

However, in the textual context of the Korean property rights clause, this separation theory is a square peg in a round hole. The German Court recognized the constitutional duty of equalisation based on the content-and-limits clause *only on the assumption* (made in the *Groundwater* case) that Article 14(3) of the German Basic Law does not apply to any type of property restriction without physical taking. This reasoning suits a literal textual interpretation of Article 14(3). In fact, even if Article 14(3) of the German Basic Law defines only 'expropriation', the German ordinary courts and the threshold theory expanded the meaning of expropriation so as to cover such restriction. By contrast, the fundamental premise of the German separation theory is that returning to the literal meaning of expropriation helps to draw a clear line between an ordinary regulation of the German Basic Law Article 14(2) and the actual taking of Article 14(3). Here, the clear and formalist standard of Article 14(3)'s expropriation is whether or not there has been an *actual taking*.

However, the scope of Article 23(3) of the Korean Constitution is broader than that of the Article 14(3) in the German Basic Law. This is because the text of Article 23(3) includes not only 'expropriation' but also 'restriction' and 'use'.¹⁴⁹ In particular, the public restriction of property under the Korean Constitution occurs without any actual taking, exactly as in the ordinary regulation of Article 23(2). By contrast, according to the German separation theory, expropriation under Article 14(3) of the German Basic Law does not include a regulation like the Korean public restriction which restricts the use of property without any actual taking. While the German separation theory deals with whether or not the expropriation takes place, the Korean Constitutional Court is required to draw a clear line between two kinds of restriction, namely the *restriction* of Articles 23(1) and (2) and the *public restriction* of Article 23(3). Finally, separation theory in Korea does not help to identify a clear standard that can be used to distinguish the regulation of Articles 23(1) and (2) from public interference (especially public restriction).¹⁵⁰

¹⁴⁸ Alexander (n 23) pp.119-21 (for more information).

¹⁴⁹ Chung (n 139) p.374.

¹⁵⁰ Ha-Joong Jeong (n 133) pp.79-80; Kim (n 140) p.14; Ryu and Park (n 99) p.521. On the other hand, some commentators have attempted to argue that the meaning of public interference under Article 23(3) of the

Nevertheless, the Korean Constitutional Court has not yet made any clear statement of the grounds for dividing the two kinds of property interference. In fact, equalisation based on the content-and-limits clause, which corresponds to the compensation-like measures, can be inferred from a clear statement to separate Article 14(1)-2 and (2) from Article 14(3) in the German Basic Law (Articles 23(2)-1 and (2) and Article 23(3) in the Korean Constitution). However, the Korean Constitutional Court has upheld the constitutional duty of the government under Articles 23(1) and (2), rather than Article 23(3), without careful analysis of the definition of public interference. In other words, the Court did not deal with the claimant's argument that the Green Belt policy breached Article 23(3). The Court should have explained why this issue should be discussed not in relation to Article 23(3) but in relation to Articles 23(1) and (2), if it was going to accept the core logic of the separation theory that the two articles are structurally separate. While the German Constitutional Court found that the reason for this separation was located in the textual meaning of expropriation in Article 14(3) of the German Basic Law, the Korean Constitutional Court should have found it in elsewhere. In the event, the Court's unclear ruling meant that it was not able to prevent the definition of interference (especially public interference) from becoming a grey area of Korean property law. All things considered, that the Korean Constitutional Court clearly accepted the German separation theory looks highly suspicious.¹⁵¹

Another question could be raised regarding the difference between the compensation-like measures of Articles 23(1) and (2) and the compensation of Article 23(3). There is a big difference in the nature and extent of these remedies. The Constitutional Court decision did not allow a plaintiff to request the direct compensation of Article 23(3) from the court order. Further, the claimant in the *Green Belt* case had to wait for a legislative measure to establish a compensation-like measure. In addition, it is possible for the government to take non-monetary government action instead of giving full-market-value-equivalent pecuniary compensation. On the other hand, compensation in Article 23(3) means the full payment of objective value (usually in a monetary form). In addition, the threshold theory allows an ordinary court to order monetary compensation without consideration by the legislature. However, the Korean Constitutional Court seems to allow relatively more legislative discretion regarding the nature and extent of compensation-like measures.

Korean Constitution coincides with the meaning of '*Enteignung*' under Article 14(3) of the German Basic Law. See Chung (n 122) pp.88-89. However, this argument clearly goes beyond the limit of any textual interpretation concerning the Korean Constitution, Article 23(3).

¹⁵¹ Chang (n 35) p.761, footnote 22.

Nevertheless, there have been some recent developments in Korean Constitutional Court cases which have further blurred the line between compensation-like measures under Articles 23(1) and (2) and compensation under Article 23(3). The Court reviewed compensation-like measures which do not include monetary compensation in the *Natural Park* case. The Natural Parks Act, like the Green Belt policy, restricts the land property in the national park zone. In the wake of the *Green Belt* case, the government established many compensation-like measures to meet the proportionality requirement, but it excluded monetary compensation. Here, five of the nine Justices admitted that the existence of monetary compensation would be closely related to the constitutionality of the relevant regulation. They then went on to strike down the regulation on the grounds of overall lack of proportionality, though four members of the majority five did not have a clear position as to whether disproportionality depends decisively on the absence of monetary compensation. On this point, Justice Kwon, Seong's opinion argued that the regulation was unconstitutional as long as it did not contain any monetary compensation for property interference.¹⁵² Nevertheless, the final decision in this case upheld the constitutionality of the regulation because of a procedural matter. According to the Korean Constitutional Court Act, two-thirds (six out of nine) Justices constitute a quorum for declaring a law unconstitutional; in the instant case, only five Justices held the relevant act to be unconstitutional.¹⁵³ Nevertheless, this case is indicative of future doctrinal developments in favour of monetary compensation. Of course, there might still be a difference between the monetary amount required by the two kinds of compensation; while Articles 23(1) and (2) are oriented on restoring proportionality, Article 23(3) focuses on the full reimbursement of property value. Nevertheless, despite these qualitative differences, nobody can pronounce firmly that future judicial rulings will not narrow the gap in terms of the final and practical consequences of these two types of compensation. In all, claimants might possibly gain the same amount and nature of remedy in a different way: while the threshold theory helps property owners to get a full compensation directly from a court decision, the Korean Constitutional Court's

¹⁵² 15-1 KCCR 371, 399-402, 99Hun-Ba110•2000Hun-Ba46, April 24, 2003 (Justice Kwon Sung's separate opinion arguing unconstitutionality).

¹⁵³ Korean Constitutional Court Act, Article 23 (Quorum):

- (1) The Full Bench shall review a case by and with the attendance of seven or more Justices.
- (2) The Full Bench shall make a decision on a case by the majority vote of Justices participating in the final discussion: It requires a vote of six or more Justices in cases of falling under any of the following:
 1. When it makes a decision of upholding on the constitutionality of statutes, impeachment, dissolution of a political party or constitutional complaint; and
 2. When it overrules the precedent on interpretation and application of the Constitution or laws made by the Constitutional Court.

future ruling is expected to allow them to gain this indirectly through the legislative procedure. If so, one could not find any meaningful difference between the compensation-like measure doctrine and the direct compensation of the threshold theory, except for the fact that the claimant has to wait for the legislature's measure in the compensation-like measure doctrine.

VI. CONCLUSION

Given the current situation, doctrinal discussion over the structural framework of Article 23 of the Korean Constitution remains in a state of confusion. Nevertheless, it looks clear that the Korean Constitutional Court will follow two steps in reviewing the constitutionality of regulations that restrict property without compensation: i) the Court will consider the character of the regulation in the course of examining whether it is based on social obligation; ii) the Court will then conduct a proportionality test by comparing the social obligation and the degree of negative effect caused by the regulation. In any case, the Court will strike down the regulation if, through the proportionality test, it recognises the occurrence of an 'expropriation-like effect', namely where government policy blocks any meaningful use of property without any provision of compensation. In addition to upholding the unconstitutionality of such measures, the Court will recognise governmental obligation for a compensation-like measure to cure the disproportionate situation, instead of giving the claimants direct and full-market value compensation. Such a decision entitles ordinary courts to issue a withdrawal order on on-going administrative acts. Also, the government is required to propose a new statute in order to accommodate the provision of compensation-like measures. Here, the claimant cannot receive any remedies for loss of property until this new act has come into effect. Of course, aggrieved property owners can argue about the nature and content of the newly established compensation-like measures if they are not satisfied by them when comparing them to the full-market-value payment they might otherwise have hoped to receive. Here, it will be controversial how the court will articulate conditions (amount or method etc.) to justify a certain compensation-like measure under the Korean Constitution. Here, the Court has not yet established solid case law specifying the standards for the constitutional nature and amount of compensation-like measures, even if it shows more sympathy with an argument in favour of monetary compensation equivalent to full-market value.

CHAPTER III

DOCTRINAL GAPS BETWEEN INDIRECT EXPROPRIATION UNDER THE KORUS-FTA AND PROPERTY RIGHTS UNDER THE KOREAN CONSTITUTION

I. INTRODUCTION

This chapter will examine how the future tribunal might consider the doctrine of indirect expropriation in investor-state arbitration under the KORUS-FTA. It will do so in order to compare the protection and restriction mechanisms of the KORUS-FTA with those of the Korean Constitution, discussed in Chapter II. The principle of property protection is incorporated into all KORUS-FTA clauses, such as the national treatment¹ or minimum standard of treatment clauses,² as part of the overall purpose of the KORUS-FTA itself. However, the doctrine of indirect expropriation is more directly related to property issues than other clauses. In particular, as outlined in Chapter I above, this doctrine has been controversial in a Korean Constitutional context because it looks foreign to Korean lawyers. This chapter will therefore focus mainly on the substantive doctrine of indirect expropriation and procedural matters relating thereto. It will consider other issues only where they are deemed relevant to an understanding of the indirect expropriation doctrine.

Some Korean critical scholars argue that the idea of property as incorporated into the KORUS-FTA is fundamentally foreign to that of the Korean Constitution.³ However, such criticisms remain vague because they could lead to the following sceptical questions: does the

¹ Free Trade Agreement between the Republic of Korea and the United States of America (KORUS-FTA) Article 11.3.

² *ibid* Article 11.5.

³ Kuk-Won Jeong, 'Korea-U.S FTA and the Public Land Law' (2008) 39 Public Land Law Review p.208; Uk-Han Lee, 'Constitutional Approaches to Indirect Expropriation of the Korea-US FTA' (2009) 15(1) Constitutional Law Studies pp.325-33.

Korean Constitution neglect property protection? Does the contemporary idea of international investment law reject Korean Constitutional doctrines that carefully distinguish legitimate regulatory power controlling the abusive use of property from malignant authoritarianism harming the proper enjoyment of property rights? It might be undeniable that there are several gaps between the two legal systems in the degree and ways in which they protect property and regulatory power. However, more careful substantive analysis is required to determine whether such doctrinal gaps could prevent the Korean government from achieving the essential constitutional values of the social state in such a severe manner that it outweighs the benefits of the KORUS-FTA such as attraction of foreign investment.

In this regard, Part II of this chapter articulates a fundamental issue around indirect expropriation doctrine by describing the chaotic development of that doctrine. Before delving into this analysis of substantive doctrines, Part III will examine the procedural issues concerning indirect expropriation litigation. Naturally, a significant part of this chapter will be concerned with the substantive issues of the indirect expropriation doctrine. However, a brief description of the procedural aspects of arbitration under Chapter 11 of the KORUS-FTA is necessary in order to understand how the wording of indirect expropriation provisions might be applied and who would have the authority to interpret the treaty. The reason is that the procedural issues surrounding indirect expropriation are related to the generation and reduction of doctrinal gaps which could jeopardise the Korean government's constitutional mandate. Then, Part IV will then anticipate how the tribunal will apply the indirect expropriation doctrine in potential KORUS-FTA claims. Next, Part V will scrutinise how successful new wording of the indirect expropriation provisions under the KORUS-FTA will be helpful to coping with indirect expropriation concerns by reducing a doctrinal gap between the Korean Constitution and the KORUS-FTA. Part VI will nevertheless reveal real, fundamental concerns rooted in the operation of the legal system beyond a simple analysis of doctrinal similarities and differences. Finally, this part serves as a more concrete and clearer linking argument which can build a bridge between the doctrinal discussions of Chapters II, III and the theoretical parts of Chapters IV and V.

II. DISTINCTION BETWEEN INDIRECT EXPROPRIATION AND COMPENSATION-NOT-REQUIRED REGULATION

A. Chaotic development of indirect expropriation

The KORUS-FTA protects property of investors under the name of investment. The KORUS-FTA Article 11.6.1 prescribes:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (expropriation), except:

- (a) for a public purpose;
- (b) in a non-discriminatory manner;
- (c) on payment of prompt, adequate, and effective compensation; and
- (d) in accordance with due process of law and Article 11.5.1 through 11.5.3.

In particular, the KORUS-FTA protects ‘a tangible or intangible property right in an investment’⁴ by preventing arbitrary expropriation. Furthermore, Annex 11-B of the KORUS-FTA categorizes this into two types of actions, viz. direct and indirect expropriation. Direct expropriation deprives an investor of the investment directly ‘through formal transfer of title or outright seizure’.⁵ On the other hand, Annex 11-B.3 of the KORUS-FTA also defines the concept of indirect expropriation as a situation ‘where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure’.⁶ In fact, direct expropriation can be easily recognized.⁷ Furthermore, this kind of physical expropriation has gradually become increasingly rare because host states are inclined to avoid apparently intrusive measures. Many investment-importing states understand that such measures frustrate future investors. In comparison to that, the issue of indirect expropriation has emerged as one of biggest issues in international investment law for the reasons outlined below.

The changing regulatory environment in nation-states leads international investment law to develop the doctrine of indirect expropriation in order to protect investors from various types of

⁴ KORUS-FTA Annex 11-B.1.

⁵ *ibid* Annex 11-B.2.

⁶ A large number of international investment treaties and arbitration decisions incorporate the idea of indirect expropriation through the use of various kinds of terminology, such as ‘de facto expropriation,’ ‘creeping expropriation,’ or measures ‘tantamount to’ or ‘equivalent to’ expropriation. The *Tecmed* case conceptualises those concepts under the umbrella of ‘indirect expropriation’. See *Tecmed v. United Mexican States*, ICSID No. ARB(AF)/00/2, Award, 29 May 2003 para.114.

⁷ Christopher F. Dugan, *Investor-State Arbitration* (Oxford University Press, 2008) pp.450-51.

excessive interference with property. As contemporary states often intervene in private property for the public welfare, the greatest challenge faced by investors is government action that nullifies the economic value of property indirectly.⁸ While states are eager to regulate the private sphere in order to achieve public political goals such as national prosperity, they do not want to be involved in expropriation claims. Therefore, host states can invent numerous creative and tactful alternatives. For instance, a contemporary government would be reluctant to directly nationalise a foreign company because such an apparent measure could give a negative signal to the future investors, even if such nationalisation is beneficial to the public. Instead, it applies other indirect ways to affect the operation of a business; for example, by imposing strict conditions for the renewal of a business permit. Alternatively, it could establish a new state-run company and make it more competitive by providing various governmental supports. Such indirect measures could abate the latent profits of its foreign competitor to the extent that it leads to the closure of the foreign undertaking. However, the investor could not argue that this government action has expropriated the investor's property directly, because there was no transfer of title nor any physical and direct interference with the property.⁹

In response to such problems, international investment law has tried to give arbitrators relatively broad discretion, enabling tribunals to review many kinds of disguised expropriation under the concept of indirect expropriation. For example, Article 1110.1 of NAFTA prescribes that '[n]o Party may directly or indirectly nationalise or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalisation or expropriation of such an investment'. However, the NAFTA text does not clarify the meaning of a 'measure tantamount to expropriation or nationalisation'. This wording allows international investment tribunals to recognize various government measures as indirect expropriation. In other investment arbitration cases, such as the *CME* case, tribunals have considered interference with contract rights belonging to an investor's local partner to be *de facto* expropriation.¹⁰ The ICSID award in the *Middle East Cement Shipping* case held that the revocation of a free zone license, which retarded the investor's business to the point of *de facto* closure, was indirect expropriation.¹¹ This kind of treaty wording gives the benefit of flexibility to an investor who is forced to face hostile and devious government measures.

⁸ M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 2010) p.389.

⁹ *ibid* pp.367-76.

¹⁰ *CME v. Czech Republic*, UNCITRAL (Netherlands/Czech Republic BIT), Partial Award, 13 September 2001.

¹¹ *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID No. ARB/99/6, Award, 12 April 2002 paras.97-129.

B. Balancing the legitimate regulatory power of the host state with investment protection

The increased protection of foreign investors of the last 20 years has recently ebbed, leading international investment lawyers and policy makers to deal with another challenging task: immunizing the legitimate regulatory power of the host state from indirect expropriation claims.¹² Taking a too investor-oriented approach to the meaning of indirect expropriation runs the risk of generating other counter-productive consequences; the broad concept of indirect expropriation can be applied to attack ordinary government policies that pursue the public interest.¹³ For example, in the *Metalclad* case,¹⁴ the host state refused to grant a construction permit and it designated the area as a national protection area for cactuses. The tribunal in this case held that this series of measures amounted to indirect expropriation ‘which has the effect of depriving the owner of the reasonably-to-be-expected economic benefit of property’.¹⁵ Additionally, the Canadian company, Methanex, submitted a Chapter 11 claim under the NAFTA on the grounds that California’s ban on Methyl Tertiary Butyl Ether (MTBE) gasoline additive amounted to an expropriation under Article 1110 of NAFTA.¹⁶ Although the claim was eventually unsuccessful, this case drew a critical attention from civil society because it illustrated that foreign investors can challenge the sovereign power which protects the public interest.

Nonetheless, international investment law does not seem to propose a clear rule to distinguish expropriation which may be compensated from that which may not, despite clearly recognising the existence of such a rule.¹⁷ As the concept of indirect expropriation has been expanded, it has suffered from inconsistency and uncertainty in interpretation. In the *Metalclad* case, the Mexican government tried to have the award made by the international arbitration panel set aside before the Canadian court. Here, the *Metalclad* award was partially annulled. The Canadian court’s reasoning for its decision includes sceptical commentary on the previous decision by the investment arbitration panel. The Court held that even if the Canadian court itself lacked authority to decide the meaning of expropriation,

¹² OECD, “‘Indirect Expropriation’ and the ‘Right to Regulate’ in International Investment Law (Working Papers on International Investment No. 2004/4)” (2004) <<http://www.oecd.org/dataoecd/22/54/33776546.pdf>> accessed 15 April 2012.

¹³ Jesse Williams, ‘Regulating Multinational Polluters in a Post-NAFTA Trade Regime: The Lessons of *Metalclad v. Mexico* and the Case for a Takings Standard’ (2003) 8(2) *UCLA Journal of International Law and Foreign Affairs* (regarding criticism of the *Metalclad* tribunal’s extensive reading of indirect expropriation).

¹⁴ *Metalclad Corporation v. United Mexican States*, ICSID No. ARB(AF)/97/1, Award, 30 August 2000.

¹⁵ *ibid* para.103.

¹⁶ *Methanex Corporation v. United States of America*, UNCITRAL (NAFTA), Final Award, 3 August 2005.

¹⁷ Sornarajah (n 8) p.390.

depriving ‘reasonably-to-be-expected economic benefits of property’ could not constitute such expropriation. The Court was concerned that such a broad understanding of NAFTA’s Article 1110 would encompass legitimate regulation within the jurisdiction of investment claims.¹⁸ Inconsistency in approach to the indirect expropriation is further indicated by the existence of conflicting decisions from different adjudicative forums on the same facts. In this instance, the *CME* case¹⁹ was dealt with in Stockholm in accordance to the Netherlands-Czech BIT, but Lauder, a shareholder of CME, made the same claim before a different forum in London in accordance with the US-Czech BIT. Contrary to the Stockholm arbitration tribunal, the London arbitration decision held that the relevant governmental action was not expropriation.²⁰

To summarise, the purpose of indirect expropriation regulation is to maintain a balance between justifiable regulatory power and the protectable property rights of foreign investors. Nevertheless, no consistent jurisprudence on indirect expropriation seems to emerge from relevant cases. This uncertainty can create anxiety for both governments and investors.

C. A new generation of indirect expropriation under the KORUS-FTA?

Given the above situation, the U.S. and Korea seem to agree on the need to control the precarious development of indirect expropriation jurisprudence. This new attitude has been motivated by several experiences which show that the broad protection of investors is not always beneficial for economically stronger states. For example, NAFTA empowered not only U.S. investors investing in the territory of another contracting party but also foreign investors within the U.S. Therefore, as seen in the *Methanex* case, NAFTA jurisprudence could be used by foreign investors to attack justifiable uses of regulatory power by the United States – even if such claims were rarely successful for the investor.²¹ Moreover, it is possible that the autonomous development of NAFTA jurisprudence could surpass the drafters’ original intent. In this context, trade policy makers in post-NAFTA treaty negotiations began using carefully-chosen language in order to

¹⁸ *The United Mexican States v. Metalclad Corporation*, Reason for Judgment of the Honourable Mr. Justice Tysoe, 2 May 2001 para.99.

¹⁹ *CME v. Czech Republic* (n 10).

²⁰ *Lauder v. Czech Republic*, UNCITRAL (United States/Czech Republic BIT), Award, 3 September 2001.

²¹ Vicki Been and Joel C. Beauvais, ‘The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine’ (2003) 78(1) New York University Law Review pp.32-39; Michael G. Parisi, ‘Moving toward Transparency-An Examination of Regulatory Takings in International Law’ (2005) 19(1) Emory International Law Review.

narrow the scope of indirect expropriation.²² Indeed, mainstream international investment law no longer insists on the absolute insulation of investors from the regulatory schemes of sovereign states.²³ Accordingly, the *Feldman v. Mexico* arbitration under the NAFTA held:

[N]ot all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110.²⁴

In other words, the investment tribunal admitted that states could not achieve their legitimate public goals if reasonable regulation is subject to an obligation of payment of compensation only on the ground of the adverse effects of regulation.²⁵

Today many new investment treaties are drafted in a way that seeks to avoid the latent problems of indirect expropriation.²⁶ In concert with this trend, the U.S. and Korea have tried to restrict the understanding of indirect expropriation within domestic legal doctrine. Both state parties had to deal with criticism of the NAFTA, whose pro-business trend has angered many environmentalists and labour activists. For instance, the U.S. Bipartisan Trade Promotion Authority Act of 2002 (hereafter ‘the U.S. Trade Act of 2002’) prescribed that the indirect expropriation provision of FTAs must be ‘consistent with United States legal principle and practice’.²⁷ This effort to respect legitimate regulatory power is reflected in the 2004 U.S. BIT Model,²⁸ which was eventually incorporated into the wording of the KORUS-FTA.

One can therefore find some evidence of an attempt to strike a balance between national regulatory power and investment protection of foreign investors in the KORUS-FTA text. For instance, the Preamble of the KORUS-FTA prescribes that foreign investors cannot receive more protection of their investment than domestic investors.²⁹ In the KORUS-FTA negotiation, the U.S.

²² J. Martin Wagner, ‘International Investment, Expropriation and Environmental Protection’ (1999) 29(3) Golden Gate University Law Review pp.465-66; Rachel D. Edsall, ‘Indirect Expropriation under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare Regulations’ (2006) 86(4) Boston University Law Review pp.931-33.

²³ Sornarajah (n 8) pp.389-90.

²⁴ *Marvin Feldman v. Mexico*, ICSID No. ARB(AF)/01/12, Award, 16 December 2002 para.103.

²⁵ Sornarajah (n 8) p.395.

²⁶ *ibid* p.390.

²⁷ 19 U.S.C. §3802(b)(3)(D). See also Williams (n 13) pp.476-77; Mark B. Baker, ‘No Country Left Behind: The Exporting of US Legal Norms Under the Guise of Economic Integration’ (2005) 19(3) Emory International Law Review pp.1337-39 (explaining the relevant factual backgrounds).

²⁸ Parisi (n 21) pp.413-23 (explaining the general trend of the U.S. post-NAFTA agreement).

²⁹ The Preamble to the KORUS-FTA:

government initially requested this provision to be adopted³⁰ in light of new U.S. trade policy goals, as found in the U.S. Trade Act of 2002.³¹ Although a Preamble cannot be independently and directly binding in and of itself, a tribunal can consider the text of such a Preamble if it has difficulty in finding any meaningful guidance for interpretation of a given clause. Under Article 31 of the Vienna Convention on the Law of Treaties (hereafter ‘VCLT’), a tribunal can interpret the ordinary meaning of a provision in the context of the treaty and in the light of its object and purpose. Here, ‘the context for the purpose of the interpretation of a treaty’ includes not only ‘the text’ but also its ‘preamble and annexes’.³²

In addition, the wording of the KORUS-FTA Chapter 11 appears to prescribe a series of terms which are reminiscent of the national doctrines of the two countries, such as the regulatory taking and special sacrifice doctrines, as will be seen in the following sections. Nevertheless, the new wording of the KORUS-FTA does not change the existing rule of international investment law in an apparently opposite way. Rather, it could be said that the drafters of the KORUS-FTA have employed an indirect but skilful strategy to deal with this issue, instead of radical change of the existing international rules or direct acceptance of the national doctrines. Indeed, the KORUS-FTA’s wording is observable not only in national legal doctrine and but also in international investment law. Whilst accentuating the common elements of both systems, the KORUS-FTA drafters have adopted their own national legal terms into the treaty text in a way that is compatible with the general rule of international investment law. To be specific, if a doctrinal controversy in case law allows several choices for arbitrators in interpreting an expropriation claim, the drafters have ensured that the review process is more compatible with the national doctrines by making the abstract languages of the treaty clearer in favour of national doctrine to the extent generally allowed under international investment law.

The government of the Republic of Korea (Korea) and the Government of the United States of America (United States) (the parties) [...] [a]greeing that foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investors rights under domestic law equal or exceed those set forth in this Agreement [...] [h]ave agreed as follows [...].

³⁰ See generally Soo-Bong Jeong, *Analysis on KORUS-FTA Investment Chapter* (Ministry of Justice in Republic of Korea, 2008) pp.348-49.

³¹ The U.S. Trade Act of 2002 ensures ‘that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States’. See 19 U.S.C §3802(b)(3).

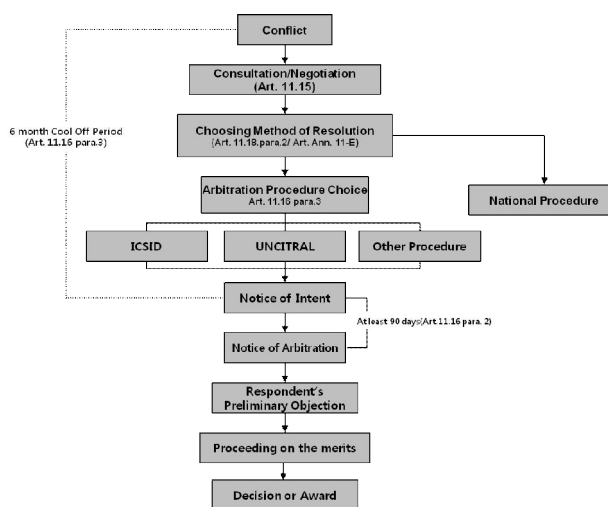
³² For example, the *Romak* case considered the preamble of a BIT in addition to other elements in the course of clarifying the ordinary meaning of the investment according to the Article 31 of Vienna Convention on the Law of Treaties (VCLT). See *Romak S.A. (Switzerland) v. The Republic of Uzbekistan*, PCA Case No. AA280, Award, 26 November 2009 paras.181-83.

This chapter will examine how successfully the above-mentioned drafting of the KORUS-FTA will make constitutionally justifiable Korean regulation immune from KORUS-FTA investment claims arguing indirect expropriation. Before this, it is necessary to examine procedural issues of investment claims in which a gap might occur because this examination is helpful for better understanding of substantial analysis of doctrinal comparison.

III. PROCEDURAL ISSUES RELATING TO INDIRECT EXPROPRIATION CLAIMS

A. State party's consent as establishment of arbitration

As discussed above, Chapter 11 of the KORUS-FTA provides a dispute settlement mechanism in which an investor can sue a host state in the event of an allegation of a breach of the KORUS-FTA.³³ The claimant can submit the claim to arbitration after initial consultation and negotiation³⁴ and a six month cooling-off period.³⁵ In such a case, a claimant can choose the arbitration forum and its related procedures, including the ICSID, the UNCITRAL or other procedures, as depicted in the following figure.³⁶



<Figure III-1> Procedure of Investor-State Dispute Settlement

³³ KORUS-FTA Article 11.16.1.

³⁴ *ibid* Article 11.15.

³⁵ *ibid* Article 11.16.3.

³⁶ *ibid*. In contrast to the KORUS-FTA, Article 1120.1 of the NAFTA does not allow any other arbitration than ICSID and UNCITRAL. However, Article 24(3)(d) of the U.S. Model BIT and Article 11.16 (3)(d) of the KORUS-FTA make it possible for a claimant to submit the investment claim under other forms of arbitration, such as ICC (International Chamber of Commerce) or LCIA (London Court of International Arbitration), SCC (Stockholm Chamber of Commerce), AAA (American Arbitration Association) or KCAB (Korean Commercial Arbitration Board) on condition of mutual agreement.

Clearly, the establishment of investor-state arbitration is formally justified only by the sovereign act of a nation-state, which has authority to conclude the treaty.³⁷ To be specific, the establishment of an investor-state dispute settlement mechanism is presumably grounded in Article 11.17 of the KORUS-FTA, which distinguishes investment arbitration from other dispute settlement systems.³⁸ An investor-state dispute settlement mechanism shares some common features with other ordinary international commercial arbitration systems in the sense that it stipulates the consent of the relevant parties.³⁹ However, one party of investor-state arbitration is usually the public authority of the state, unlike in commercial arbitration, which is based on the private autonomy of both parties.⁴⁰ Most importantly and most controversially, treaty-based arbitration, like the KORUS-FTA arbitration, gives preliminary and general consent to all possible future disputes.⁴¹ Paulsson considers this type of arbitration to be ‘arbitration without privity’ in the sense that ‘it creates privity at the time of initiating arbitration’.⁴²

Although Harten argues that Paulsson’s description remains within the theoretical framework of private law, he admits that Paulsson sheds some light on the point that the general consent clause of an investment treaty makes investment arbitration distinguishable from contract-based arbitration between a private foreign investor and a state.⁴³ To be specific, in commercial arbitration, the state is presumed to act mainly in a private capacity at the international level, regardless of its sovereign status at the national level.⁴⁴ This type of arbitration contains a clear jurisdictional limitation.⁴⁵ For example, even if a contract includes consent to arbitration in advance, the effect of such consent is applicable only to the specific relationship between the investor and the host state involved. Also, where the consent is given after the occurrence of a dispute, its jurisdictional effect will extend only to that particular dispute. However, treaty-based arbitration, combined with blanket-consent provisions, allows any potential investor from the state parties to have a right to invoke a legal claim against the host state,⁴⁶ and the state is forced to enter into the

³⁷ Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) p.65.

³⁸ *ibid* pp.58-71. See also Zachary Douglas, ‘The Hybrid Foundations of Investment Treaty Arbitration’ (2004) 74(1) *British Yearbook of International Law* (regarding general description of hybrid features of investment treaty arbitration systems).

³⁹ Jan Paulsson, ‘Arbitration without Privity’ (1995) 10(2) *ICSID Review*.

⁴⁰ Harten (n 37) pp.58-59.

⁴¹ *ibid* p.63.

⁴² Paulsson (n 39) p.247.

⁴³ Harten (n 37) pp.64-65.

⁴⁴ *ibid* pp.62-63.

⁴⁵ *ibid* p.62.

⁴⁶ Paulsson (n 39) p.233.

litigation according to this consent clause, as long as the claim meets jurisdictional and procedural requirements.⁴⁷

B. Choice of dispute settlement

While the contracting states to the KORUS-FTA have given their prior written consent to arbitration under Article 11.17.1, Article 11.18.2 – similarly to Article 1121.2(b) of the NAFTA⁴⁸ – requires claimants to forswear other national or international remedies for the relevant measure, including consent to arbitration in another forum. This provision prevents a claimant from using an investment arbitration mechanism in parallel to a national court or other judicial forums for policy reasons. It does so to ensure unnecessary additional protections are not granted to investors and to prevent the multiplication of jurisdictions. Also, this provision is intended to control a possible conflict between the domestic judicial decisions and arbitration rulings on the same issue.⁴⁹ Some categorise this NAFTA provision as a ‘fork in the road’ provision that does not allow claimants to change their initial forum choice after the initiation of proceedings.⁵⁰

Dolzer and Schreuer cast some doubt on this position.⁵¹ The investor in a NAFTA case is allowed to take a U-turn and go back to investment arbitration. The same applies to the KORUS-FTA provision; suppose a Korean investor could submit a dispute to a U.S. court. The claimant could give up ‘continuing’ before the U.S. court by deciding not to appeal to the higher court and could then initiate the KORUS-FTA arbitration. In addition, the tribunal in the *Waste Management II* case made it clear that Article 1121.2.(b) of NAFTA is not a typical ‘fork in the road’ provision,

⁴⁷ Harten (n 37) pp.62-63.

⁴⁸ NAFTA, Article 1121.2:

A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:

- (a) consent to arbitration in accordance with the procedures set out in this Agreement; and
- (b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

⁴⁹ See generally David A. Gantz, ‘The Evolution of FTA Investment Provisions: From NAFTA to the United States-Chile Free Trade Agreement’ (2003) 19(4) *American University International Law Review* pp.755-58; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) pp.216-17.

⁵⁰ e.g. Harten (n 37) p.69.

⁵¹ Dolzer and Schreuer (n 49) p.216 footnote 19.

because a waiver is required of the investor only when the investor submit a claim under Article 1120, regardless of the commencement of any prior national remedy.⁵²

If there were not Annex 11-E of the KORUS-FTA, the waiver clause would run a risk of being at odds with Korean constitutional arrangements, where the Court can consider international law as a legal source for proceeding without any implementing legislation. Indeed, the KORUS-FTA prevents a U.S. investor from withdrawing her or his initial choice of remedy due to the difference in the constitutional practices of both countries.

The Korean Courts could consider the treaty to be an applicable legal source in accordance with Article 6(1) of the Korean Constitution.⁵³ In fact, there is controversy over the meaning of ‘generally recognised rules of international law’. Especially, the Korean Court has not made a clear case law as to whether the Article 6(1) of the Korean Constitution includes the international laws which are not formally concluded and promulgated by the Korean government but generally respected by many countries.⁵⁴ For example, where the claimant argued that ILO Conventions No. 87 and No. 151 were considered as generally recognised rules of international law, the Korean Constitutional Court denied their domestic effect simply on the ground that the Korean government has not ratified those conventions. The Court did not recognise those conventions as a generally recognised rule of international law without any further reasoning for its conceptual conditions.⁵⁵ However, it is generally agreed that a Korean court can use a treaty as a formal legal source equivalent to national statutes if the Korean National Assembly has approved the treaty in accordance with Article 60(1) of the Korean Constitution.⁵⁶ In addition, a foreign legal person can, in principle, have equal access to the court in terms of constitutional right unless the treaty

⁵² *Waste Management, Inc. v. United Mexican States* (Number 2), ICSID No. ARB(AF)/00/3, Jurisdiction (for second claim), 30 April 2004 paras.29-30.

⁵³ Korean Constitution, Article 6 (1): ‘Treaties duly concluded and promulgated under the Constitution and the generally recognized rules of international law shall have the same force and effect of law as the domestic laws of the Republic of Korea’.

⁵⁴ Kyong Soo Jung, ‘Korean Legal System and Experience on Domestic Application of International Law’ (2008) 28 *Korea International Law Review* pp.105-06.

⁵⁵ 19-2 KCCR 213, 233-34, 2003 Hun-Ba51, August 30 2007.

⁵⁶ Bokhyeon Nam and others, *International Treaty and Constitutional Review* (Korean Constitutional Court, 2007) pp.377-87; Jung (n 54) pp.106-07. Korean Constitutional Court cases are consistent with this argument. See 10-2 KCCR 685, 686, 97Hun-Ba65, November 26, 1998; 11-1 KCCR 273, 282-83, 97Hun-Ga14, April 29, 1999; 13-2 KCCR 322, 322, 2000Hun-Ba20, September 27, 2000. For example, the Korean Supreme Court invalidated the municipal ordinance that encouraged the dining facilities of local schools to use local agricultural products according to the Agreement on Government Procurement of the WTO. See Supreme Court of Korea Decision 2004Chu10 Declared September 9, 2005.

prescribes otherwise.⁵⁷ This means that a U.S. investor could initiate judicial proceedings before the Korean courts on the grounds of a breach of the KORUS-FTA, provided that this is not otherwise prescribed by the treaty or by relevant national laws.

Given this setting, if there were not any additional provisions, a U.S. investor could give up continuing a further remedy before a Korean court and instead he or she could start the KORUS-FTA arbitration procedure. Here, suppose that the Korean court rejects the claimant's argument by interpreting the same clause of the KORUS-FTA in an opposite way. If so, there may be an interpretive conflict over the same KORUS-FTA provision on the same government action between the Korean courts and the KORUS-FTA arbitration tribunal. In order to address this problem, the KORUS-FTA has made an additional rule for Korea, similar to that concerning Mexico in Article 1120.1 of the NAFTA. Here, a U.S. investor's initial choice of judicial forum is final and irreversible.⁵⁸

On the other hand, the U.S. legal system does not entail such a possibility of judicial conflict between national courts and investment tribunals in interpreting the same KORUS-FTA clauses. This is because the KORUS-FTA is not considered to be a domestically effective treaty to which U.S. courts can refer under the U.S. Constitution. Similarly to Article 6(1) of the Korean Constitution, Article VI, Clause 2, of the U.S. Constitution, considers 'all treaties made, or which shall be made, under the Authority of the United States' to be 'the supreme Law of the Land' which binds 'the Judges in every State'. Therefore, these treaties principally prevail over any state law within the U.S.⁵⁹ In relation to treaty making, the U.S. Constitution requires the U.S. President to conclude treaties 'by and with the Advice and Consent of the Senate, to make treaties provided two thirds of the Senators concur'.⁶⁰ In practice, however, it is difficult to obtain the consent of two thirds of Senators for various political reasons; for example, the two-party political system hinders

⁵⁷ There is a general agreement that a basic right of Korean Constitutional Law is applicable to a foreign legal person unless a treaty, such as the FTA, prescribes otherwise. Of course, some rights, such as the right to election, might be of limited application to foreigners due to their inherent nature. Even if there is controversy over the scope of the right of a foreign corporation, such rights could certainly be guaranteed at least within national legislation and treaties. See Young-Soo Chang, *Constitutional Law* (Hongmunsa, 2007) pp.472-75; Cheol-Su Kim, *New Theory of Constitutional Law* (Bagyeongsa, 2009) pp.308-10 (explaining the scholarly discussion concerning protection of a foreigner's property). See 6-2 KCCR 477, 93Hun-Ma120, December 29, 1994; 13-2 KCCR 714, 99Hun-Ma494, November 29, 2001 (regarding the Constitutional Court cases which address the property rights of foreigners). From a legislative perspective, Article 3 of the Framework Act on the Treatment of Foreigners Residing in the Republic of Korea guarantees the economic activities of foreigners in Korea.

⁵⁸ KORUS-FTA Annex 11-E.2.

⁵⁹ *State of Missouri v. Holland*, 252 U.S. 416 (1920).

⁶⁰ The Constitution of the United States Article II, Section 2, Clause 2.

treaties proposed by one party from obtaining overwhelming support from the Senate. Therefore, the U.S. executive branch has a long tradition of constitutional practice that concludes many international agreements in the form of an executive agreement, circumventing the rigorous constitutional requirements of treaty-making.⁶¹ However, some kinds of executive agreement such as free trade agreements are established in the form of a congressional executive agreement, under the oversight of Congress.⁶² To be specific, the U.S. Trade Act of 2002 prescribes that a free trade agreement such as the KORUS-FTA can be domestically effective on the condition of enactment of implementing legislation, which reflects the content of the treaty.⁶³ Section 102(a) of the United States-Korea Free Trade Agreement Implementation Act (hereafter ‘US KORUS-FTA Implementation Act’) prescribes that U.S. law prevails over arguably conflicting KORUS-FTA.⁶⁴ Also, a Korean investor cannot ask for a legal remedy in any U.S. court on the ground of a breach of the KORUS-FTA.⁶⁵ Even so, Korean investors can challenge government measures before the U.S. courts on the basis of U.S. laws implementing the KORUS-FTA or other U.S. laws applicable

⁶¹ See generally Congressional Research Service Library of Congress, *Treaties and Other International Agreements: The Role of the United States Senate* (U.S. Government Printing Office, 2001) <<http://www.gpo.gov/fdsys/pkg/CPRT-106SPRT66922/pdf/CPRT-106SPRT66922.pdf>> accessed 15 April 2012. The U.S. Supreme Court has generally upheld the power of the President to conclude these executive agreements. See also *United State v. Belmont*, 301 U.S. 324 (1937); *Dames & Moore v. Regan*, 453 U.S. 654 (1981); *United State v. Pink*, 315 U.S. 203 (1942).

⁶² Congressional Research Service Library of Congress (n 61) p.5, p.79 and p.240; Emily C. Barbour, ‘Trade Promotion Authority and the U.S.-South Korea Free Trade Agreement’ (2011) pp.1-2 <<http://www.fas.org/sgp/crs/row/R41544.pdf>> accessed 15 April 2012.

⁶³ 19 U.S.C §3805(a).

⁶⁴ United States-Korea Free Trade Agreement Implementation Act (U.S. KORUS-FTA Implementation Act), Pub. L. 112-41, §102(a), 125 Stat. 428, 430 (2011):

Relationship of Agreement to United States Law.—

- (1) United States Law to Prevail in Conflict.—No provision of the Agreement, nor the application of any such provision to any person or circumstance, which is inconsistent with any law of the United States shall have effect.
- (2) Construction.—Nothing in this Act shall be construed—
 - (A) to amend or modify any law of the United States, or
 - (B) to limit any authority conferred under any law of the United States, unless specifically provided for in this Act.

⁶⁵ U.S. KORUS-FTA Implementation Act United States-Korea Free Trade Agreement Implementation Act, Pub. L. 112-41, §102(c), 125 Stat. 428, 430-431 (2011):

Effect of Agreement with Respect to Private Remedies.—

No person other than the United States—

- (1) shall have any cause of action or defense under the Agreement or by virtue of congressional approval thereof; or
- (2) may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State, on the ground that such action or inaction is inconsistent with the Agreement.

to U.S. nationals. Alternatively, Korean investors can trigger the Chapter 11 arbitration directly before investor-state arbitration on the grounds of KORUS-FTA.

Some Koreans accuse this U.S. implementation act of procedural unfairness.⁶⁶ They argue that the U.S. legal system prevents Korean investors from using any national remedy based on the KORUS-FTA, whereas the Korean legal system allows U.S. investors to use the KORUS-FTA as a legal source before its national courts. Therefore, it is said that this mechanism would discriminate against Korean investors when the implementation acts of the US allegedly fail to guarantee a level of investment protection that the KORUS-FTA intends. In the case of Korea, a U.S. investor could submit a legal claim to a Korean court by arguing that the Korean legislation for KORUS-FTA implementation violates the treaty obligation through direct reference to KORUS-FTA clauses. On the other hand, a Korean investor could not raise a claim before a U.S. court on the grounds of violation of the relevant KORUS-FTA clauses. Consequently, the Korean investor is effectively forced to choose investment arbitration.

Contrary to such a popular criticism, it is doubtful that the current procedures of the KORUS-FTA under the two countries' constitutional arrangements avail absolutely in favour of U.S. claimants. When a host state legislates in violation of the KORUS-FTA, it is true that the U.S. investor in Korea could file a case against the Korean government by direct reference to the KORUS-FTA. In deciding to raise a KORUS-FTA claim in Korea, however, the U.S. claimant would undertake the risk that any other remedy would not be available after the Korean court repudiates the claim. This is because the KORUS-FTA's Article 11.18.2(b) and Annex 11-E prevents a losing claimant from turning back to Chapter 11 arbitration after losing the case. More importantly, this risk would become more palpable given that the Korean court reviews breaches of KORUS-FTA obligations by reference to Korean legal sources and under Korean constitutional principles.⁶⁷ Therefore, it may be much safer for the U.S. investor to raise a claim based on a breach of Korean national law or the constitution once he or she decides to ask for any national remedy in Korea. Taking the example of an expropriation claim, it may be a wiser strategy for a U.S. investor to refer to Article 23 of the Korean Constitution or other relevant national statutes than to Article 11.6 or Annex 11-B of the KORUS-FTA. This is because the U.S. investor would not thereby extinguish an opportunity for further Chapter 11 Arbitration by direct reference to the

⁶⁶ Eun-Joo Jung, 'Only an American Investor Can Raise a Claim... Only Korea Is Obligated to Revise the Law in the Case of Conflict between the KORUS-FTA and Korean Law' *The Hankyoreh* (4 October 2011) <http://www.hani.co.kr/arti/economy/economy_general/499305.html> accessed 15 April 2012.

⁶⁷ See Chapter III. Part VI (explaining the risks that foreign investor should assume when the national court applies the KORUS-FTA without recourse to investor-state arbitration).

KORUS-FTA. In consequence, it is highly questionable that U.S. investors would have more choices in terms of strategy for legal remedies than Korean investors. In the perspective of the risk assessment, U.S. investors may rarely use the KORUS-FTA as a legal source when considering national remedies to governmental measures.

Although the waiver clause of the KORUS-FTA allows the host state to respond with an objection to deny access to the international investment arbitration on the ground of an investor's previous use of other remedies, tribunals have recognized this objection by the state only when the host state can prove that the same person has raised the same dispute involving the same cause of action.⁶⁸ For example, in the *CMS* case, a subsidiary company of investors made a legal claim on a contractual arrangement under the licence according to Argentine national proceedings.⁶⁹ The Argentine government argued that the company's involvement in the national proceedings should be construed as waiving the rights of the investor to submit the dispute to arbitration according to a waiver provision.⁷⁰ This argument is based on the presumption that an investor is factually identical to a company shareholder initiating a national legal remedy before the investment arbitration.⁷¹ Nevertheless, the tribunal repudiated this objection to jurisdiction, and distinguished the involved investor from its company.⁷² In relation to this issue, the KORUS-FTA requires written waivers 'of any right to initiate or continue before any administrative tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding' regarding the relevant dispute, not only from the investor but also from the investors' enterprise.⁷³ Therefore, the KORUS-FTA reduces the burden on the tribunal to identify the investor and its subsidiary. In the *CMS* case, the arbitration tribunal also examined the identity of the causes of action in the two

⁶⁸ Christoph Schreuer, 'Investment Treaty Arbitration and Jurisdiction over Contract Claims – the *Vivendi I* Case Considered' in Todd Weiler (ed) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May, 2005) pp.301-07; Dolzer and Schreuer (n 49) pp.216-17.

⁶⁹ *CMS Gas Transmission Company v. Argentina*, ICSID No. ARB/01/8, Decision on Jurisdiction, 17 July 2003.

⁷⁰ *ibid* para.77.

⁷¹ The Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, Article VII 3.(a):

Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) [national procedures] and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration [...].

⁷² *CMS v. Argentina* (n 69) para.80.

⁷³ KORUS-FTA Article 11.18.2(b)(ii).

relevant procedures.⁷⁴ On this point, the tribunal held that the cause of action before the national court involved a contractual arrangement under the licence, whereas the relevant claim before the arbitration tribunal dealt with a breach of the investors' rights under the Argentina-US BIT.⁷⁵ This reasoning is compatible with the *Middle East Cement* case,⁷⁶ where the host state seized and auctioned the claimant's ship. In response to this measure, the claimant sought remedy from the Egyptian government to nullify the auction. The tribunal held that a dispute brought in the national courts is not related to a dispute between a claimant and the host state under the Egypt-Greece BIT. Therefore, this use of national litigation does not exclude the admissibility of arbitration.⁷⁷ This means that not every appearance before a national court would preclude resort to international investment arbitration, as long as the investor could successfully dispute the identity of the two legal disputes.⁷⁸

C. Applicable laws in arbitration for independent review of the tribunal

KORUS-FTA arbitration tribunals are composed of three arbitrators unless the disputing parties agree otherwise. Each party can appoint one person; and the presiding arbitrator should be appointed through agreement of the two parties.⁷⁹ The ICSID Secretary-General retains authority to appoint arbitrators or the presiding arbitrator in a case where the disputing parties can not draw up a mutual agreement.⁸⁰ When the Secretary General exercises the authority of appointment, she or he should exclude a national of either party from acting as presiding arbitrator.⁸¹

Arbitrators do not act in favour of the particular parties who appoint them. Many arbitration rules, including Article 14(1) of the ICSID convention, and Articles 9 and 12 of the UNCITRAL rule, prescribe a series of qualifications, such as morality, neutrality or speciality, and so on. In addition, Articles 20 and 21 of the KORUS-FTA are concerned with the transparency and neutrality of arbitration. The most important point is that an arbitrator should stick only to the governing laws of the KORUS-FTA and that they themselves should be independent of any national bias.

⁷⁴ *CMS v. Argentina* (n 69) para.80.

⁷⁵ *ibid* para.80. See also *Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic*, ICSID No. ARB/01/3, Decision on Jurisdiction, 14 January 2004 paras.97-98.

⁷⁶ *Middle East Cement Shipping v. Egypt* (n 11).

⁷⁷ *ibid* para.70.

⁷⁸ Christoph Schreuer, 'Travelling the BIT Route: of Waiting Periods, Umbrella Clauses and Forks in the Road' (2004) 5(2) *Journal of World Investment and Trade* p.241.

⁷⁹ KORUS-FTA Article 11.19.1.

⁸⁰ *ibid* Article 11.19.2.

⁸¹ *ibid* Article 11.19.3.

The KORUS-FTA arbitration tribunal considers, as its governing laws, the KORUS-FTA treaty and the applicable rule of international law when the claim is concerned with treaty obligations.⁸² In particular, arbitrators⁸³ frequently rely on several principles of treaty interpretation enshrined in Article 31 of the VCLT.⁸⁴ Additionally, tribunals sometimes consider ‘supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion’ under the Article 32⁸⁵ of the VCLT in the course of applying Article 31.⁸⁶

In addition, Article 11.22.3 of the KORUS-FTA prescribes that the interpretation of the treaty is bound by the declarations of the KORUS-FTA Joint Committee, established in accordance with Article 22.2 of the KORUS-FTA. This committee is co-chaired by the United States Trade Representative and the Minister for Trade of Korea; its main tasks are to supervise and manage the overall implementation and administrative issues of the treaty and to seek resolution regarding its interpretation and application.⁸⁷ Additionally, it can issue interpretations of the KORUS-FTA provisions in relation to the governing laws of Chapter 11.⁸⁸ The nature and effect of these

⁸² *ibid* Article 11.22.1.

⁸³ e.g. *Methanex v. United States of America* (n 16) Part II, Ch. B, para.16; *Siemens A.G v. The Republic of Argentina*, ICSID No. ARB/02/8, Decision on Jurisdiction, 3 August 2004 para.80.

⁸⁴ VCLT, Article 31(General rule of interpretation):

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
 - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
 - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
 - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
 - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
 - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

⁸⁵ VCLT Article 32 (Supplementary means of interpretation):

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

⁸⁶ See *Noble Ventures v. Romania*, ICSID No. ARB/01/11, Award, 12 October 2005 para.50.

⁸⁷ KORUS-FTA Article 22.2.2.

⁸⁸ *ibid* Article 22.2.3(d).

interpretations may be controversial, however, as shown in NAFTA's *Pope & Talbot* case. During litigation proceedings, the NAFTA Free Trade Commission (hereafter 'FTC'), which is similar to the KORUS-FTA Joint Committee, issued an interpretative statement to narrow down the applicable scope of the minimum standard of treatment. The arbitration tribunal was suspicious about whether this interpretation was merely an interpretation or a disguised amendment.⁸⁹ Despite this uncertainty, the tribunal in the *Pope & Talbot* case regarded the interpretative statement as binding on the tribunal's own interpretation.⁹⁰ This respect for the FTC's interpretation was further upheld in subsequent NAFTA cases.⁹¹ For example, the *ADF* arbitration panel did not seem to deny this line of case law, although it held that a Chapter 11 tribunal does not have any authority to determine whether an 'interpretation' is actually an amendment or not.⁹²

Moreover, other international investment decisions could be considered in applying the treaty to any given case, even if the treaty text does not explicitly prescribe this. Tribunals often rely on previous decisions in other cases of investment arbitration when they cannot find instructive guidance from any other source of international law or the investment treaty text itself.⁹³ This does not mean that a doctrine of precedent, similar to that found in common law, is established in international investment law.⁹⁴ Indeed, individual decisions do not have any supremacy over the treaty and any formally binding precedential value over future decisions. This is because each tribunal is established 'ad hoc for the particular case'.⁹⁵ More importantly, Article 11.26.5 of the KORUS-FTA denies any 'binding force except between the disputing parties and in respect of the particular case'. Nevertheless, the denial of the formally binding effect of previous decisions does not necessarily prevent future tribunals in different cases from referring to the reasoning of a previous arbitration decision. Tribunals have consistently held that they can consider the decisions

⁸⁹ See generally Gantz (n 49) pp.716-20; Matthew C. Porterfield, 'An International Common Law of Investor Rights?' (2006) 27(1) University of Pennsylvania Journal of International Economic Law pp.88-92. See also Charles H. Browe II, 'Fair and Equitable Treatment under NAFTA's Investment Chapter' (2002) 96 Proceedings of the Annual Meeting (American Society of International Law) p.10 (regarding critical comments on the issuing of the interpretive statement).

⁹⁰ *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL (NAFTA), Award in Respect of Damage, May 31, 2002 paras.43-51.

⁹¹ *Mondev International Ltd. v. United States of America*, ICSID No. ARB(AF)/99/2, Award, 11 October 2002 paras.94-126.

⁹² *ADF Group Inc. v. United States of America*, ICSID No. ARB(AF)/00/1, Award, 9 January 2003 para.177.

⁹³ Christoph Schreuer, 'Diversity and Harmonization of Treaty Interpretation in Investment Arbitration' in M. Fitzmaurice, O. A. Elias and Panos Merkouris (eds), *Treaty interpretation and the Vienna Convention on the Law of Treaties: 30 Years on* (Martinus Nijhoff Publishers, 2010) p.139.

⁹⁴ *ibid.*

⁹⁵ *ibid.* In a similar vein, there is some controversy over the precedential value of Iran-US Claims Tribunal decisions, even though many current arbitrations refer to them in practice. See generally Charles Nelson Brower and Jason D. Brueschke, *The Iran-United States Claims Tribunal* (Martinus Nijhoff, 1998) pp.651-54.

produced by other arbitration bodies, despite the absence of formal binding effects, as long as they deem those decisions illustrative of interpretation on the same clause or dealing with similar issues.⁹⁶

IV. KORUS-FTA TRIBUNAL'S REVIEW OF INDIRECT EXPROPRIATION CLAIMS

While the previous part examined the procedural structure in which expropriation doctrines are produced, the following part conducts a comparative analysis in order to examine a doctrinal gap between the two legal systems at issue. This doctrinal analysis will help us to know whether a constitutionally justifiable regulation under the Korean Constitution could be challenged by a foreign investor or investment tribunal on the ground that it breaches the indirect expropriation provision under the KORUS-FTA. This research will go on to examine whether this substantive gap is too broad to be negotiable in light of the essential goals of the Korean Constitution and international investment law. In this regard, the following part will explore how tribunals under the KORUS-FTA will review substantive issues relating to investment protection and restriction in the course of indirect expropriation claims, especially by examining how the Korean and U.S. Courts decide similar issues. This will also concern analysis of how the new wording of the KORUS-FTA, inspired by indirect expropriation concerns, would affect a future tribunal's review in terms of protecting the regulatory power of the host state.

A. Conditions for the constitution of indirect expropriation claims

The indirect expropriation provisions of KORUS-FTA deal only with governmental measures that indirectly expropriate the covered investments.⁹⁷ In this context, the meaning of 'covered investments' and relevant 'measures' should be clarified as they control the scope of the indirect expropriation doctrine.

⁹⁶ *Amco Asia Corporation and others v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Ad hoc Committee Decision on the Application for Annulment, 16 May, 1986 para.44; *AWG Group v. The Argentine Republic*, UNCITRAL (UK/Argentina BIT), Decision on Liability, 30 July 2010 para.189; *Liberian Eastern Timber Corporation(LETCO) v. Republic of Liberia*, ICSID Case No. ARB/83/2, Award, March 31, 1986, p.9. Additionally, a NAFTA case under the ICSID Additional Facility followed the same line. See *Feldman v. Mexico* (n 24) para.107.

⁹⁷ KORUS-FTA Article 11.6.1.

i) The meaning of investment

The doctrine of indirect expropriation is applicable only to ‘covered investments’.⁹⁸ Articulating the term ‘investment’ therefore serves as one of the preliminary stages to controlling the applicable scope of the indirect expropriation doctrine. As a matter of fact, the concept of investment comes from the economic or everyday notion.⁹⁹ On the other hand, investment treaties and laws are oriented on the reciprocal economic development of the state party. Therefore, too broad or purely-economic a notion of investment would cover ordinary commercial transactions, going beyond the intentions of the contracting states. Such ordinary commercial transactions, established between private actors and the state acting *as another private actor*, should be considered according to international commercial law without reference to the investment treaty and the ICSID system. For example, ICSID arbitration excludes pure commercial transactions from the types of investment falling within the jurisdiction of the ICSID Convention.¹⁰⁰ Additionally, ICSID’s Secretary-General has refused to register a case raised in connection with a simple sale of goods by excluding it from the investments covered by the ICSID Convention.¹⁰¹ Despite the significance of the concept of investment, the meaning of ‘investment’ is still one of the most controversial and complicated issues in the international investment law.¹⁰²

Tribunals take their departure for interpreting the term ‘investment’ by articulating the terms of the relevant treaty text according to Articles 31 and 32 of the VCLT.¹⁰³ The KORUS-FTA essentially maintains a broad, open-ended definition; as such, a tribunal can recognize anything that

⁹⁸ *ibid.*

⁹⁹ Noah Rubin, ‘The Notion of “Investment” in International Investment Arbitration’ in Norbert Horn and Stefan Kröll (eds), *Arbitrating Foreign Investment Disputes* (Kluwer Law International, 2004) pp.283-284. See also Rudolf Dolzer, ‘The Notion of Investment in Recent Practice’ in Steve Charnovitz, Debra P. Steger and Peter van den Bossche (eds), *Law in the Service of Human Dignity: Essays in Honour of Florentino Feliciano* (Cambridge University Press, 2005) p.263 (explaining an economic understanding of investment). See also Jeswald W. Salacuse, *The Law of Investment Treaties* (Oxford University Press, 2010) pp.18-19 (explaining an ordinary understanding of investment).

¹⁰⁰ *Global Trading Resource Corp. and Globex International, Inc. v. Ukraine*, ICSID Case No. ARB/09/11, Award, 1 December 2010 para.56.

¹⁰¹ Ibrahim F.I. Shihata and Antonio R. Parra, ‘The Experience of the International Centre for Settlement of Investment Disputes’ (1999) 14(2) ICSID Review: Foreign Investment Law Journal p.308.

¹⁰² Devashish Krishan, ‘A Notion of ICSID Investment’ in Todd Weiler (ed) *Investment Treaty Arbitration and International Law. Vol. 1* (JurisNet, 2008); Sébastien Manciaux, ‘The Notion of Investment: New Controversies’ (2008) 9(6) The Journal of World Investment & Trade; Emmanuel Gaillard, ‘Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice’ in Christina Binder (ed) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press, 2009).

¹⁰³ *Global Trading Resource v. Ukraine* (n 100) para.47.

has the characteristics of an investment by following a general trend found in other BITs.¹⁰⁴ This broad conception of an investment is compatible with the complicated economic settings in which an investment might exist in various forms, such as physical or non-physical assets, cash or securities. In articulating the definition of a ‘covered investment’ in the Article 11.1.1(b) of the KORUS-FTA, Article 11.28 of KORUS-FTA considers an investment as being ‘every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment’. Thereafter, the Article provides a series of examples (*footnote omitted*):

- (a) an enterprise;
- (b) shares, stocks, and other forms of equity participation in an enterprise;
- (c) bonds, debentures, other debt instruments, and loans;
- (d) futures, options, and other derivatives;
- (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;
- (f) intellectual property rights;
- (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and
- (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

Some forms of investment are more specifically defined for clarity. For example, ‘[s]ome forms of debt, such as bonds, debentures, and long-term notes are more likely to have the character of investments’.¹⁰⁵ In addition, orders or judicial decisions, such as administrative or judicial actions, are excluded from the definition of an investment.¹⁰⁶ Licenses, authorizations, permits and similar rights, however, could be recognized as investments as long as one could identify amongst them the characteristics of an investment by examining the relevant domestic law.¹⁰⁷

The list enumerated in Article 11.28 is not exhaustive, and ‘the characteristics of an investment’¹⁰⁸ define whether a certain type of investment belongs to those addressed by the KORUS-FTA. ICSID arbitration decisions can be considered as very influential sources of guidance in defining the meaning of investment. For example, the *Romak* tribunal, constituted

¹⁰⁴ Antonio Parra, ‘The Scope of New Investment Laws and International Instruments’ in Robert Pritchard (ed) *Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in a New Era* (Kluwer Law International, 1996) p.35; Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration* (Sweet & Maxwell, 2004) pp.570-71; Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff, 1995) pp.25-31 (providing definitions prescribed in other BITs).

¹⁰⁵ KORUS-FTA Article 11.28 footnote 10.

¹⁰⁶ *ibid* Article 11.28 footnote 12.

¹⁰⁷ *ibid* Article 11.28 footnote 11.

¹⁰⁸ *ibid* Article 11.28.

under the UNCITRAL Arbitration Rules, began by articulating the ordinary meaning of ‘investment’ under the Switzerland-Uzbekistan BIT in accordance with Articles 31 and 32 of the VCLT.¹⁰⁹ It held that there is an objective meaning of investment that goes beyond literal or mechanical interpretations by focusing on the ‘context’ or ‘object and purpose’ of the treaty as per Article 31 of VCLT.¹¹⁰ In addition, the tribunal argued that a mechanical interpretation could cause an absurd or unreasonable result in the context of Article 32(b) of the VCLT.¹¹¹ The *Romak* tribunal concluded that ICSID arbitration decisions are helpful in drawing an outline of the objective meaning of the term ‘investment’.¹¹² Indeed, such ICSID cases are produced in the course of dealing with the jurisdictional issues relative to Article 25(1) of the ICSID Convention.¹¹³ This Article prescribes that ‘[t]he jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment’ between the parties. Therefore, the ICSID tribunal’s Convention can deny jurisdiction for claims where the investment in question is not compatible with the objective and autonomous meaning of investment in the ICSID Convention, irrespective of whether the relevant investment meets the conceptual criteria for investment under the treaty.¹¹⁴ In this context, the claimant in the *Romak* case argued that the conceptual scope of investment before the UNCITRAL Arbitration procedure is different from that under ICSID Arbitration.¹¹⁵ However, the tribunal did not admit this argument because such an interpretation could lead to the unreasonable result that the forum choice affects the degree of substantive investment protection.¹¹⁶ In this context, UNCITRAL Arbitration panels in the *Romak* case can consider ICSID reasoning in the sense that arbitrations are required to determine the inherent and ordinary meaning of investment – whether under the BIT or ICSID Convention.¹¹⁷

In short, leading ICSID arbitration decisions could be cited for use as meaningful guidelines for a KORUS-FTA tribunal to articulate the conceptual scope of investment. The *Fedax* case is one of the early cases in which investment arbitration attempted to articulate the notion of an

¹⁰⁹ *Romak v. Uzbekistan* (n 32) paras.173ff.

¹¹⁰ *ibid* paras.180-83.

¹¹¹ *ibid* paras.184-87.

¹¹² *ibid* para.190.

¹¹³ *ibid* para.192.

¹¹⁴ Christoph Schreuer, *The ICSID Convention: A Commentary* (University of Cambridge, 2009) p.117-19. See also *Global Trading Resource v. Ukraine* (n 100) para.43-46; *Joy Mining v. Egypt*, ICSID No. ARB/03/11, Award on Jurisdiction, 6 August 2004 para.50; *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award, 14 July 2010 paras.108-09.

¹¹⁵ *Romak v. Uzbekistan* (n 32) para.193.

¹¹⁶ *ibid* para.194.

¹¹⁷ *ibid* para.194-95.

investment.¹¹⁸ Here, the claimant, incorporated in the Netherlands, acquired a promissory note issued by the Venezuelan government in the secondary market by endorsement. The respondent government refused to pay for the promissory note. The arbitration tribunal, established by the Netherlands-Venezuela BIT, rejected the Venezuelan government's contention that a promissory note is not included as a classic type of investment. The tribunal held that 'it is a standard feature of many international finance transactions that the funds involved are not physically transferred to the territory of the host country but are at its disposal elsewhere'.¹¹⁹ This reasoning shows that the notion of investment is indifferent as to whether a physical form of a certain asset is involved in the inflow into the host state.¹²⁰ Instead, the tribunal held that 'the basic features of an investment have been described as involving a certain duration, a certain regularity of profits and returns, an assumption of risk, a substantial commitment and a significance for the host state's development'.¹²¹ Under those requirements, the tribunal defined a promissory note as being an investment; in particular, the tribunal found a correlation between the transaction and the host state's development by examining the law governing the promissory note. Indeed, the government could maintain the sound development of public finances for a certain duration when the claimant has a promissory note for long-term regular profits.¹²²

These principles have been developed more elaborately in the *Salini* case in 2001. Here, the tribunal held that the term 'investment' covered a motorway construction contract that was established by an Italian construction company and a Moroccan government-controlled company. In order to recognize the contract as an investment, the arbitrator proposed four criteria (the *Salini* test),¹²³ namely, i) a contribution by the investor, ii) a certain duration of the project, iii) the existence of operational risk, and iv) a contribution to the host state's development.¹²⁴ It is useful to examine the elements of *Salini* test because the KORUS-FTA already proposes several concepts of *Salini* test as examples of the characteristics possessed by an investment; e.g. 'the commitment of capital or other resources', 'the assumption of risk'.¹²⁵

¹¹⁸ *Fedax N.V. v. Republic of Venezuela*, ICSID No. ARB/96/3, Decision on Objections to Jurisdiction, 11 July 1997.

¹¹⁹ *ibid* para.41.

¹²⁰ Redfern and Hunter (n 104) p.571.

¹²¹ *Fedax v. Venezuela* (n 118) para.43.

¹²² *ibid* para.42-43.

¹²³ *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID No. ARB/00/4, Decision on Jurisdiction, 27 September 2001.

¹²⁴ Dolzer and Schreuer (n 49) p.68. This categorisation may have been influenced by Schreuer's comments on this issue. See also Schreuer (n 114) p.128-30.

¹²⁵ KORUS-FTA Article 11.28.

a) *Contribution of the investor*: Any financial resource or transfer of know-how, equipment or personnel can be considered to be a ‘contribution’. In *Salini*, the tribunal readily upheld the contribution of the investors in putting their financial or personal resources into the relevant road construction.¹²⁶

b) *A certain duration of the project*: Regarding the duration of the contribution in the second factor, while records of the negotiation of the ICSID convention reveal that state parties suggested that five years was appropriate, subsequent arbitration decisions have established that duration need not be excessively rigorous,¹²⁷ holding that a two-year period could be considered sufficient.¹²⁸ The *Salini* tribunal upheld the 36 months that the company spent on performing the contract as an appropriate duration.¹²⁹

c) *Existence of operational risk*: An investment usually entails some risk because of its long duration and the uncertainty of expected profits. For example, the exploration of natural resources usually involves a significant risk that the company will not find the wanted natural resources. If so, the company may not reimburse any spending in the case of failure in searching for the natural resource. To take another instance, a long-term project such as an infrastructure construction plan tends to involve more unexpected risks which are outside the investor’s control. These risks can be recognised only by a careful analysis of the nature of the relevant investments, because the risks might vary from case to case.¹³⁰ In the *Salini* case, the claimants took part in a construction plan even though they had considered a series of risks which might occur due to unexpected changes in the situation. To take one example, the Italian company argued that it tolerated a risk by admitting the possible increment in the cost which might be caused by an amendment to Moroccan law.¹³¹

¹²⁶ *Salini v. Morocco* (n 123) para.52. This reasoning is followed in subsequent arbitration. See *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID No. ARB/03/29, Decision on Jurisdiction, 14 November 2005 para.131; *Saipem S.p.A. v. People’s Republic of Bangladesh*, ICSID No. ARB/05/7, Decision on Jurisdiction and Recommendation on Provisional Measures, March 21, 2007 para.100.

¹²⁷ Christoph Schreuer, ‘Commentary on the ICSID Convention’ (1996) 11(2) ICSID Review: Foreign Investment Law Journal pp.318-493. See also *Bayindir v. Pakistan* (n 126) para.133; *Consortium Groupement L.E.S.I. – DIPENTA v. People’s Democratic Republic of Algeria*, ICSID No. ARB/03/8, Award, 10 January 2005. pp.450-53.

¹²⁸ *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt*, ICSID No. ARB/04/13, 16 June 2006 paras.93-96.

¹²⁹ *Salini v. Morocco* (n 123) para.54.

¹³⁰ Dugan (n 7) p.270; Sornarajah (n 8) pp.69-79 (explaining many different types of risk).

¹³¹ *Salini v. Morocco* (n 123) paras.55-56.

d) Contribution to the host state's development: Lastly, the national contribution of an investment represents an element that can be used to describe its characteristics.¹³² The *Salini* case held that this factor could be justified by the Preamble of the ICSID Convention which considers the economic development of a host state as being one of the goals of the convention.¹³³ A KORUS-FTA tribunal could possibly consider this factor on the basis of the Preamble to the KORUS-FTA, which states that it intends to advance the national economic development in both state parties. This last factor, however, is highly controversial;¹³⁴ although some tribunals consider this factor in defining the investment,¹³⁵ they do not seem to draw any consistent rule on the necessary extent of the contribution to national economic development. For example, the *Malaysian Historical Salvors* case recognized only the significant contribution of an investment,¹³⁶ whereas the *Patrick Mitchell* case held that it does not matter whether or not the contribution is significant.¹³⁷ The *Malaysian Historical Salvors* award was eventually annulled by an ad hoc committee.¹³⁸ On the other hand, the *LESI Dipenta* case held that a tribunal does not need to consider this factor separately because the fourth factor in *Salini* is difficult to be recognised and is implicitly incorporated into the other three factors.¹³⁹ In the recent *Saba Fakes* case, the tribunal argued that the contribution that an investment makes to the economic development of a host state is just 'an expected consequence, not a separate requirement, of the investment'.¹⁴⁰

Even if many tribunals present different characteristics for identifying an investment, they at least seem to reach a general consensus on three criteria: '(i) contribution (ii) a certain duration (iii) a element of risk'.¹⁴¹ In applying the *Salini* test, there is no consensus on whether those standards must be met cumulatively.¹⁴² Schreuer argues that even if one or two elements of the

¹³² Walid Ben Hamida, 'Two Nebulous ICSID Features: The Notion of Investment and the Scope of Annulment Control – Ad Hoc Committee's Decision in *Patrick Mitchell v. Democratic Republic of Congo*' (2007) 24(3) *Journal of International Arbitration* p.296; Dugan (n 7) p.272; Schreuer (n 114) pp.131-34.

¹³³ *Salini v. Morocco* (n 123) para.52.

¹³⁴ Dolzer and Schreuer (n 49) p.69; Schreuer (n 114) p.131.

¹³⁵ *Malaysian Historical Salvors, SDN, BHD v. Malaysia*, ICSID No. ARB/05/10, Award, 17 May 2007; *Patrick Mitchell v. Democratic Republic of the Congo*, ICSID No. ARB/99/7, Decision on the Application for Annulment of the Award, 1 November 2006.

¹³⁶ *Malaysian Historical Salvors v. Malaysia* (n 135) para.123. See also *Bayindir v. Pakistan* (n 126) para.137; *Československa obchodní banka, a.s. v. Slovak Republic*, ICSID No. ARB/97/4, Decision on Objections to Jurisdiction, 24 May 1999 para.88; *Joy Mining v. Egypt* (n 114) para.57.

¹³⁷ *Patrick Mitchell v. Congo* (n 135) para.33.

¹³⁸ *Malaysian Historical Salvors, SDN, BHD v. Malaysia*, ICSID No. ARB/05/10, Decision on the Application for Annulment, 16 April 2009 para.80.

¹³⁹ *L.E.S.I. – DIPENTA v. Algeria* (n 127) pp.449-50; *LESI. S.p.A. and Astaldi, S.p.A. v. People's Democratic Republic of Algeria*, ICSID No. ARB/05/3, Decision on Jurisdiction, 12 July 2006 para.72.

¹⁴⁰ *Saba Fakes v. Turkey* (n 114) para.111.

¹⁴¹ *ibid* para.121.

¹⁴² Gaillard (n 102) pp.407-11.

Salini test is missing, a tribunal can recognise the existence of an investment because the elements are proposed simply as examples.¹⁴³ This assertion is grounded on the assumption that such a understanding of the *Salini* test runs a risk of restricting the scope of protectable investment.¹⁴⁴ On the other hand, in practice the tribunal attempts to understand the concept of investment for jurisdictional requirements by using fixed standards.¹⁴⁵ Proponents of this approach argue that Schreuer's flexible approach *de facto* abandons the objective definition of the term 'investment'.¹⁴⁶ As a result, if certain factors are recognised as elements of the definition of investment, they should be assessed in a totality based on the particular circumstances of the individual case.¹⁴⁷

ii) Conditions for expropriation claims under the KORUS-FTA

As discussed in the Chapter II, the Korean Constitution actually restricts property rights and expands the regulatory power of the government by adjusting the contents of the notion of property. Similarly, the KORUS-FTA controls the protectable scope of an investment by adjusting the contents of investment.

Firstly, claims under Article 11.6 of the KORUS FTA can be raised only when a governmental measure 'interferes with a tangible or intangible property in an investment'.¹⁴⁸ This wording is different from the 2004 U.S. Model BIT, which the KORUS-FTA drafters considered to be a basic model; specifically, this Model BIT clearly prescribes 'property interests in an investment' as a ground for an expropriation claim,¹⁴⁹ whereas the KORUS-FTA drafters attempted to exclude 'property interests' from the content of investment protection secured under Article 11.6 of the KORUS-FTA.¹⁵⁰ The concept of property interests was initially discussed in the previous NAFTA *Pope & Talbot* case.¹⁵¹ In this case, a U.S. investor owned a wood product company. In 1996, the Canadian and U.S. governments established a bilateral agreement, the Softwood Lumber Agreement, which controlled the free export of softwood lumber. The claimant argued that measures taken by the Canadian government under this agreement violated the NAFTA,

¹⁴³ Schreuer (n 114) pp.132-33.

¹⁴⁴ Gaillard (n 102) pp.407-10 (mapping out other arguments to support Schreuer's view).

¹⁴⁵ *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, ICSID Case No. ARB/98/2, Award, May 8, 2008 para.232.

¹⁴⁶ Gaillard (n 102) pp.410-11.

¹⁴⁷ e.g. *Bayindir v. Pakistan* (n 126) para.130; *Joy Mining v. Egypt* (n 114) para.53.

¹⁴⁸ KORUS-FTA Annex 11-B.1.

¹⁴⁹ 2004 US Model BIT, Annex B.2: 'An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment'.

¹⁵⁰ Jeong (n 30) pp.117-18.

¹⁵¹ *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL (NAFTA), Interim Award, 26 June 2000.

Chapter 11. Here, the Canadian government argued that the definition of investment in Chapter 11 does not cover access to the U.S. market.¹⁵² However, the tribunal in this case held that the ‘investment’s access to the US market is a property interest subject to protection’ and therefore subject to the protection of the NAFTA direct or indirect expropriation clause.¹⁵³ Subsequently, the 2004 U.S. Model BIT made it clearer that property interests should be protected.¹⁵⁴ In comparison, Annex 11-B.1 of the KORUS-FTA has attempted to deny the doctrine of property interests by omitting that term. Of course, such a property interest is still protected under other clauses of Chapter 11 of the KORUS-FTA than Article 11.6. However, it might look certain that the claimant could not raise an indirect expropriation claim solely on the ground of interference with a property interest.

Secondly, the *Feldman v. Mexico* tribunal held that not all kinds of reduction in profit constitute expropriation because the government can change a law or regulation that influences profit in business.¹⁵⁵ This implies that the protectable scope of an investment under the indirect expropriation doctrine is not related to mere profit diminution caused by the regulation.¹⁵⁶

Such modification and legal practices would make the KORUS-FTA’s indirect expropriation more compatible with Korean constitutional doctrine¹⁵⁷ excluding ‘mere profit, a simple chance to gain profit or the factual or legal environment of a commercial enterprise’ from being protectable property.¹⁵⁸

iii) The meaning of ‘measure’

The meaning of ‘measure’ is another issue in KORUS-FTA indirect expropriation claims as one aspect of a property restriction is defined by the scope of a measure ‘adopted and maintained’ by the government or by non-governmental bodies delegated by the government.¹⁵⁹ Recognition of government measures encompassing a broad scope tends to enable investment tribunals to consider a greater variety of government action under the name of investment. The definition of a measure in

¹⁵² *ibid* para.92.

¹⁵³ *ibid* para.96. See also *Chemtura Corporation (Formerly Crompton Corporation) v. Government of Canada*, UNCITRAL (NAFTA), Award, 2 August 2010 para.248.

¹⁵⁴ 2004 US Model BIT Annex 11-B.2.

¹⁵⁵ *Feldman v. Mexico* (n 24) para.112.

¹⁵⁶ Sornarajah (n 8) p.395.

¹⁵⁷ Jeong (n 30) p.118.

¹⁵⁸ 10-2 KCCR 283, 309-10, 96Hun-Ma246, July 16, 1998; 14-2 KCCR 29, 44, 99Hun-Ma574, July 18, 2002. See also 8-2 KCCR 90, 103, 95Hun-Ba36 August 29, 1996; 9-2 KCCR 651, 664, 97Hun-Ba10 November 27, 1997 (regarding other similar reasoning).

¹⁵⁹ KORUS-FTA Article 11.1.3.

Article 11.1.3 of the KORUS-FTA is specified in Article 1.4, which states that a ‘measure includes any law, regulation, procedure, requirement, or practice’. This wording is exactly the same as Article 1 of the 2004 U.S. Model BIT and Article 201 of NAFTA. Regarding NAFTA’s Article 201, the Canadian Statement on Implementation states that ‘measure’ is ‘a non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions’.¹⁶⁰

This broad definition was discussed in the *Loewen* case, where the claimant argued that unfair and inappropriate administration of justice in U.S. courts violated the investment protection clauses enumerated in Chapter 11, including the expropriation provisions.¹⁶¹ In this case, the NAFTA tribunal rejected the respondent state’s contention that judicial acts are not covered by the jurisdiction of NAFTA arbitration.¹⁶² The tribunal referred to a series of the International Court of Justice or the European Court of Justice cases¹⁶³ which attempted to articulate the meaning of a measure.¹⁶⁴ Finally, the tribunal considered the conduct of any organ of the state as an act of state, regardless of its position in the organization of that state; it therefore included legislative, executive and judicial actions as per Article 4 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts.¹⁶⁵

B. Three factors for tribunal reviews

The tribunal will reject an investment claim when the government has exercised its regulatory power in accordance with several conditions: i) for a legitimate public purpose; ii) in a non-discriminatory way; and iii) with prompt, adequate and effective compensation. In addition, that regulatory power should be exercised in accordance with due process and a minimum standard of treatment.¹⁶⁶ Nevertheless, these conditions do not suffice to solve all latent problems. Therefore, the U.S. and Korean governments tried to codify a recent trend of international arbitration cases and the national legal doctrine in Annex 11-B of the KORUS-FTA in order to guide expropriation claims and their review, as illustrated in the following section.

¹⁶⁰ Government of Canada, ‘Canadian Statement on Implementation’ (1 January 1994) Canada Gazette Part I p.80.

¹⁶¹ *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID No. ARB(AF)/98/3, Decision on Hearing of Respondent’s Objection to Competence and Jurisdiction, 5 January 2001 para.30.

¹⁶² *ibid* para.32.

¹⁶³ e.g. *Fisheries Jurisdiction (Spain v. Canada)*, Jurisdiction of the Court, Judgment, ICJ Reports 432 (1998) paras.64-73; *Régina v. Pierre Bouchereau*, Case 30-77 (1977) European Court Reports p.1999.

¹⁶⁴ *Loewen v. United States of America* (n 161) paras.45-60.

¹⁶⁵ *ibid* para.70; *Oil Fields of Texas, Inc. v. Iran Oil Field of Texas, Inc. v. The Government of the Islamic Republic of Iran, National Iranian Oil Company*, Case No. 42, 12 Iran-U.S. Claims Tribunal Reports (1986) para.42).

¹⁶⁶ KORUS-FTA Article 11.6.1.

Firstly, (indirect or direct) expropriation is defined as an action or a series of actions by the host state which interferes with a tangible or intangible property right in an investment.¹⁶⁷ Annex 11-B of the KORUS-FTA attempts to define indirect expropriation as a situation ‘where an action or a series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure’.¹⁶⁸

The guidance for the indirect expropriation review by an arbitration tribunal is further specified by Annex 11-B.3(a) and (b) of the KORUS-FTA. Here, the KORUS-FTA attempts to control how a tribunal might rule on indirect expropriation claims. Firstly, the tribunal’s review should be based on a case-by-case and fact-based analysis. This wording accentuates that factual circumstances, rather than a particular doctrine, are more useful in dealing with indirect expropriation claims. Indeed, many international investment lawyers support this approach.¹⁶⁹ Furthermore, the KORUS-FTA requires the tribunal’s inquiry into indirect expropriation to consider at least the following three factors, prescribed in Annex 11-B.3(a): i) ‘the economic impact of the government action’ (the effect of the measure); ii) ‘the character of the government action’; and iii) ‘the extent to which the government action interferes with distinct, reasonable investment-backed expectations’ (legitimate expectation).

Regarding these three factors, some scholars understand that this new wording incorporates the U.S. legal doctrine of *regulatory taking*.¹⁷⁰ This doctrine originated in the *Pennsylvania Coal* case, which held that ‘while property may be regulated, to a certain extent, if regulation goes too far it will be recognized as a taking’.¹⁷¹ In fact, this doctrine has raised the controversial constitutional issue of whether a clear line exists between mere regulation and taking.¹⁷² The aftermath of the

¹⁶⁷ *ibid* Annex 11-B.1.

¹⁶⁸ *ibid* Annex 11-B.3.

¹⁶⁹ L. Yves Fortier and Stephen L. Drymer, ‘Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor’ (2004) 19(2) ICSID Review pp.326-27; Dugan (n 7) p.450.

¹⁷⁰ Gantz (n 49) pp.745-46; Marc R. Poirier, ‘The NAFTA Chapter 11 Expropriation Debate through the Eyes of a Property Theorist’ (2003) 33(4) Environmental Law pp.912-14; Amy K. Anderson, ‘Individual Rights and Investor Protections in a Trade Regime: NAFTA and CAFTA’ (2006) 63(3) Washington and Lee Law Review pp.1086-87; Peter Charles Choharis, ‘Regulatory Takings under International Law: A Brief Legal and Practical Guide’ in Theodore H. Moran, General T. West and Gerald-Keith Martin (eds), *International Political Risk Management: Needs of the Present, Challenges for the Future* (World Bank, 2008) p.120; Jordan C. Khan, ‘Investment Protection Under the Proposed ASEAN-United States Free Trade Agreement’ (2010) 33(2) Suffolk Transnational Law Review pp.243-49. See also Jeong (n 30) p.119; Min-Ho Kim and Jee-Yop Kim, ‘Indirect Expropriation in the Korea-U.S. FTA and the Korean Compensation Requirement under the Constitution’ (2008) 39 Public Land Law Review p.14 (regarding the Korean situation).

¹⁷¹ *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

¹⁷² Joseph L. Sax, ‘Takings and the Police Power’ (1964) 74(1) Yale Law Journal; Richard Allen Epstein, *Takings: Private Property and the Power of Eminent Domain* (Harvard University Press, 1985) pp.100-04.

Pennsylvania Coal case has created an extremely complicated and inconsistent area of U.S. law.¹⁷³ The U.S. Supreme Court finally handed down a landmark decision regarding regulatory taking in the *Penn Central Transportation* case. The Court ruled on New York City's landmarks preservation law, which restricted historic landmarks from undergoing development. It identified several factors that should be considered when determining a regulatory taking case:

The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. [...] So, too, is the character of the governmental action.¹⁷⁴

Whether or not the drafters of the KORUS-FTA and the 2004 U.S. Model BIT were inspired by U.S. regulatory taking, it would be an exaggeration to claim that the indirect expropriation doctrine under the treaty is dominated only by U.S. regulatory taking. First of all, in the course of drafting the KORUS-FTA drafters considered not only U.S. legal doctrines but also Korean ones, as seen in the following sections. Indeed, in negotiating the KORUS-FTA, U.S. trade policy makers seem to have incorporated the legal doctrines of their partner state more extensively than in other previous post-NAFTA U.S. investment treaties.

Most importantly, it is worth noting that the three above factors were already observable in international investment law at the time of drafting. In this context, the new wording is nothing more than a clear codification of current trends found in many investment arbitrations. Therefore, tribunals interpret those factors in the context of international investment law by referring not to national legal decisions but to other investment cases.¹⁷⁵ It might be appropriate to recognise that these three factors are universally found in general notions of property in any legal systems. In other words, international and national lawyers seem to deal with a common legal issue in a similar way and in the same context of a tension between property protection and regulatory power.¹⁷⁶ As some terms provide clearer guidance to a KORUS-FTA tribunal facing several doctrinal controversies,

¹⁷³ William A. Fischel, *Regulatory Takings: Law, Economics, and Politics* (Harvard University Press, 1995); David L. Callies, *Takings: Land-development Conditions and Regulatory Takings after Dolan and Lucas* (Section of State and Local Government Law, American Bar Association, 1996); George Skouras, *Takings Law and the Supreme Court: Judicial Oversight of the Regulatory State's Acquisition, Use and Control of Private Property* (Peter Lang, 2000).

¹⁷⁴ *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 123 (1978).

¹⁷⁵ For example, the tribunal in the *Glamis Gold* case understood that the parties cited the *Penn Central* doctrine not because it was an applicable law but because it could be considered to be 'a well-developed body of law'. See *Glamis Gold Ltd v. United States of America*, UNCITRAL (NAFTA), Award, 8 June 2009 para.356 footnote 703.

¹⁷⁶ e.g. Sornarajah (n 8) pp.383-89 (showing the general direction of doctrinal development shared by international investment law and many national legal systems).

such guidance could implicitly work to promote a greater affinity with national property law. Nevertheless, this wording is not fundamentally against the principles of international investment law.

In this sense, the following sections will focus predominantly on demonstrating how a tribunal under the KORUS-FTA would interpret the above three factors from an international investment law perspective. Additionally, this thesis will consider the U.S. doctrine of regulatory taking and the reasoning in the Korean *Greenbelt* case, in order to show how differently and similarly national and international legal systems deal with the same issue from the comparative perspective.

i) Effects of the measures

It might generally be accepted that the effect of a measure is one of the most important elements for constituting indirect expropriation in international investment law.¹⁷⁷ While the KORUS-FTA also considers this factor, it prevents a tribunal from considering only the consequential effects of governmental measures by forcing it to consider other factors also. In other words, in a case where the effect of a measure is the only grounds to constitute indirect expropriation, a tribunal would repudiate the claimant's assertion of indirect expropriation. Therefore, Annex-B.3(a)(ii) of the KORUS-FTA prescribes that 'the economic impact of the government action [...] standing alone' does not constitute expropriation. This understanding is consistent with the *Penn Central* reasoning; while the court analyzes the factual effect of regulation, it is required to consider other factors such as the character of investment-backed expectations or government action.¹⁷⁸

This codification is clearly directed against the so-called sole effect doctrine. Indeed, some early investment arbitration cases appear to have employed this controversial doctrine, which requires the tribunal to focus only on the effect of a governmental measure holding other circumstantial elements, such as the purpose of the regulation, to be either less relevant or not relevant at all. Thus, the distinguishable feature of the sole effect doctrine is that the tribunal does not consider any factors other than the actual effect of the governmental measure.¹⁷⁹

¹⁷⁷ Dolzer and Stevens (n 104) p.100; Dugan (n 7) p.455.

¹⁷⁸ *Penn Central Transportation v. New York City* (n 174).

¹⁷⁹ Rudolf Dolzer, 'Indirect Expropriations: New Developments' (2002) 11(1) New York University Environmental Law Journal pp.79-80.

The approach of sole effect can be seen in the *Trippetts* case before the Iran-United States Claims Tribunal.¹⁸⁰ Here, a U.S. company had been involved in the Tehran International Airport project, establishing a joint venture with an Iranian company. This joint venture was controlled by mutually equal rights between the two partner companies. After the Iranian revolution, however, the Iranian government appointed a new manager to the Iranian company, which was authorized to exclusively control the management of the joint venture. The tribunal regarded this appointment as a kind of expropriation which deprived the U.S. company owner of the full value of the property. Here, the tribunal held that '[t]he intent of the government is less important than the effects of the measure on the owner, and the form of the measure of control or interference is less important than the reality of their impact'.¹⁸¹ The later *Biloune* case was consistent with this ruling.¹⁸² In that case, government authorities had interrupted the investor's enterprise by way of a number of governmental actions and inactions, including financial scrutiny, the issuance of a working stop order and the detention and deportation of the investors. The respondents contended that those actions were justified according to the national law of the host state and that they were not related to the investment. However, the tribunal found that whilst the intention of the government was ambiguous, its effect was clear enough to constitute constructive expropriation. Consequently, the tribunal upheld the claim of constructive expropriation by relying only on the effect of the governmental action.¹⁸³ Finally, the NAFTA arbitration in the *Metalclad* case seems to follow the *Biloune* ruling in holding that interrupting a land fill enterprise in an ecological preservation zone was a case of indirect expropriation;¹⁸⁴ the tribunal held that it did not need to decide or consider the motivation or intention behind the government action, such as environmental protection, in assessing the existence of indirect expropriation.¹⁸⁵

Contrary to this, another approach requires the tribunal to consider other elements, such as the government's purpose in carrying out expropriation.¹⁸⁶ For example, in the *Oscar Chinn* case the tribunal addressed a Belgian government regulation to control transportation prices in favour of Chinn's competitor, Unatra,¹⁸⁷ by helping to reduce Unatra's transportation fee. As a result, Chinn

¹⁸⁰ *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA et al.*, Case No. 7, 6 Iran-United States Claims Tribunal Reports (1984).

¹⁸¹ *ibid* pp.225-26.

¹⁸² *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, UNCITRAL (Investment Agreement, Law of Ghana, International law), Award on Jurisdiction and Liability (27 October 1989) and Award on Damages and Costs (30 June 1990).

¹⁸³ *ibid* p.209.

¹⁸⁴ *Metalclad Corporation v. United Mexican States* (n 14) para.108.

¹⁸⁵ *ibid* paras.109-11.

¹⁸⁶ Fortier and Drymer (n 169) pp.313-14.

¹⁸⁷ *Oscar Chinn Case* (Britain v. Belgium), PCIJ, Ser. A/B., No. 63, 1934.

became less competitive, to the extent that it was no longer able to run its enterprise. The Permanent Court of International Justice, however, did not recognize any taking to have occurred, holding that '[f]avourable business conditions and good will are transient circumstances, subject to inevitable changes'.¹⁸⁸ The general idea of this approach was followed by the *Sea-Land* case in the Iran-United States Claims Tribunal. Here the claimant argued that a series of governmental actions, such as the inappropriate operation of container terminals or remiss attitudes of staff, deprived the company of the use of terminal facilities. This adverse effect of the government action affected the claimant's worldwide flow of containers. The tribunal considered, however, as the important factors for the recognition of expropriation, a series of circumstantial elements leading the government to behave thus. It found that the deterioration in terminal administration was affected by unavoidable national upheaval occasioned by the Iranian revolution or that the alleged governmental interruption was concerned with exercising justifiable regulatory power.¹⁸⁹ This trend was recognized in the NAFTA case of *S.D. Myers*.¹⁹⁰ In that case, the plaintiff was a U.S. corporation involved in the disposal and processing of the toxic chemical substance, polychlorinated biphenyl (hereafter 'PCB') waste. The company entered the Canadian PCB disposal market in 1993, and gained the U.S. government's approval to import PCB waste from Canada to the US. Its Canadian competitors were worried that this export of PCB waste to the U.S. had dismantled the competitive situation of the Canadian PCB disposal market because S.D Myers could dispose of much of the PCB waste in its U.S. plant. In response to this situation, the Canadian government banned the export of PCB waste from its territory. Finally, S.D. Myers invoked an investment claim, including an alleged violation of NAFTA, Article 1110; namely that the Canadian ban on PCB waste exports indirectly expropriated their investment by removing any possibility of bringing and disposing of PCB waste in the U.S. plant, with accompanying claims concerning the violation of other provisions, like NAFTA Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment) and 1106 (Performance Requirements). While the tribunal upheld the violation of Articles 1102 and 1105, it rejected the claimant's arguments in respect of Articles 1106 and 1110 (expropriation provisions). In particular, the reasoning in its partial award

¹⁸⁸ *ibid* p.88. See also *Antoine Goetz and others v. Republic of Burundi*, ICSID No. ARB/95/3, Award, 10 February, 1999 p.505.

¹⁸⁹ *Sea-Land Service, Inc. v. Iran Sea-Land Service, Inc. v. The Islamic Republic of Iran, Ports and Shipping Organization of Iran*, Case No. 33, 6 Iran-U.S. Claims Tribunal Reports (1984) pp.164-66.

¹⁹⁰ *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL (NAFTA), Partial Award, 13 November 2000.

held that the assessment of the expropriation considered ‘the real interests involved and the purpose and effect of the government measure’ rather than ‘technical or facial considerations’.¹⁹¹

In any case, an all-or-nothing approach is unacceptable in terms of current notions of the indirect expropriation doctrine. Of course, the sole effect doctrine could foreclose *any disguised* public interest by denying *all kinds of* public interest. Indeed, public purpose or public interest are such extremely abstract concepts that a government could take advantage of their conceptual flexibility in order to strike down a claim. The simplest way of avoiding this ambiguity, therefore, is to prevent a tribunal from touching on these issues from the outset. Certainly, no one could deny that the sole effect approach could fundamentally and efficiently block any abuse of governmental power. However, the problem is that this black-or-white approach runs a risk of eliminating all scope for the exercise of *justifiable regulatory power* by the host state, just as too strong a pesticide exterminates not only harmful insects but also beneficial ones. Looking at it from the other side, although it is certainly guaranteed that the sole effect doctrine would firmly protect all private interests, this might require a tribunal to turn a blind eye to the abusive use of private rights by neglecting a government’s legitimate purpose in producing regulations. As outlined in the introduction to this chapter, the idea of investment protection is to develop not an all-or-nothing logic but an elaborate a framework that can carefully distinguish mere abuse of private rights from justifiable regulatory power and the protectable right of an investor.

In this context, Dolzer and Bloch conclude that an assessment of the regulatory effect should be placed within the broader context to balance it with an assessment of other relevant factors.¹⁹² Of course, the severity of a regulation will still serve to be an undeniably important factor in distinguishing taking from mere justifiable regulation. The *Glamis Gold* tribunal argued that assessing the degree of adverse impact on an investment (‘the severity of the economic impact and the duration of that impact’) is a ‘foundational threshold inquiry’ although other elements can be considered for inquiry for indirect expropriation.¹⁹³ In addition, it could be said that the effect of government measures is more relevant than their purpose.¹⁹⁴ However, the indirect expropriation cannot be constituted solely by assessing severity of regulatory effect to the same extent that a mere reference to the purpose or intention of a regulation would not render a host state immune from an investment claim. In addition, the *Chemtura* tribunal argued that the degree to which a government

¹⁹¹ *ibid* para.285. See also Rudolf Dolzer and Felix Bloch, ‘Indirect Expropriation: Conceptual Realignment?’ (2003) 5(3) International Law FORUM du droit international pp.159-62 (regarding a more detailed analysis).

¹⁹² Dolzer and Bloch (n 191); Gantz (n 49) pp.163-64.

¹⁹³ *Glamis Gold v. United States of America* (n 175) para.356.

¹⁹⁴ *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011 paras.328-30.

measure has an adverse impact is determined differently depending on the specific circumstances. Therefore, it found that it could not conduct an appropriate inquiry of indirect expropriation without considering other circumstantial elements related to the facts of the case.¹⁹⁵ In this context, the wording of the KORUS-FTA clearly binds the tribunal to consider other aspects of a regulation than its severity. This is consistently supported by other NAFTA arbitration.¹⁹⁶

Interestingly, a similar doctrinal debate can be found in Korean property law. In fact, there has been controversy over whether the government should pay compensation even for unintentional or non-purposive government actions which interfere with property;¹⁹⁷ this comes from the German doctrine of expropriatory interference (*enteignender Eingriff*). This doctrine represents an expansion of the threshold theory, paying particular attention to the severity of the regulation. Therefore, the doctrine goes further than the threshold theory, to the extent that even a legal administrative act requires compensation as long as its consequences would harm a particular property holder in a disproportionate way.¹⁹⁸ The Korean Constitutional Court has been silent on this issue and Korean scholarship is still very cautious about accepting the doctrine.¹⁹⁹ The reason for this reticence is similar to the criticisms of the sole-effect doctrine; while the concept of expropriatory interference could be useful in preventing a government action which was conducted *accidentally on purpose*, it runs the risk of attacking the public protection of social justice. Given the current debate regarding this doctrine, it looks highly questionable whether a plaintiff could argue for just compensation for a government action solely on the grounds of severity.

ii) Legitimate expectation

The legitimate expectation of the investor would serve as one of the important factors in assessing the severity of the adverse effects of a regulation. Generally speaking, an investor usually expects a future situation in the phase of planning the investment. For instance, the investor could decide to build a landfill site on the basis of a reasonable expectation that the authority would not revoke the construction permit suddenly and arbitrarily. In this case, if the government neglects such a legitimate expectation, that action would constitute an expropriation. Similarly, U.S. taking

¹⁹⁵ *Chemtura v. Canada* (n 153) para.249.

¹⁹⁶ *ibid.*

¹⁹⁷ Jee-Tae Ryu and Jong-Soo Park, *Administrative Law* (Parkyoungsa, 2009) pp.544-45.

¹⁹⁸ See generally Hee-Sung Song, 'Expropriation-like Interference and Expropriatory Interference' (2000) 41(11) *Sabeophaengjeong* pp.19-21.

¹⁹⁹ Lee (n 3) p.331; Ryu and Park (n 197) p.545.

doctrine protects the reasonable expectations of the property holder;²⁰⁰ this reasonable expectation would be established on the basis of an investor's consideration of circumstantial evidence, such as the risk inherent in the industry, and the relationship between the property and the relevant regulatory schemes. The scope of this reasonably-justified expectation is in proportion with the regulatory circumstances in which the government exercises power.²⁰¹ Therefore it is harder to claim the rightful recognition of a reasonable expectation when the property owner is informed that the property is situated in a more densely-regulated and more changeable area.²⁰²

In this context, the KORUS-FTA considers the extent to which reasonable investment-backed expectations are protected through the Annex 11-B.3(a)(ii) of the KORUS-FTA. Actually, this doctrine has been more frequently used in the context of fair and equitable standards of treatment.²⁰³ For example, the *Thunderbird* case attempted to define a legitimate expectation:

The concept of 'legitimate expectations' relates, [...] to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA party to honour those expectations could cause the investor (or investment) to suffer damages.²⁰⁴

However, international arbitration tribunals have also relied on this doctrine in a number of indirect expropriation cases. Among the NAFTA cases, the *Metalclad* case held that a belief based on a representation by the Mexican government and the absence of a timely, orderly, or substantive basis for the denial by the municipality of the local construction were protectable and legitimate expectations.²⁰⁵ In the *Azurix* case, the tribunal held that legitimate expectations 'are not necessarily based on a contract but on assurances explicit or implicit, or on representations, made by the State which the investor took into account in making the investment'.²⁰⁶ This doctrine was somewhat controversial; in partially annulling the arbitration award in *Metalclad* case, the Canadian

²⁰⁰ See generally R.S. Radford and J. David Breemer, 'The (Less?) Murky Doctrine of Investment-Backed Expectations After Palazzolo, and the Lower Courts' Disturbing Insistence on Wallowing in the Pre-Palazzolo Muck' (2005) 34(3) Southwestern University Law Review.

²⁰¹ See generally Dugan (n 7) p.485.

²⁰² *Connolly v. Pension Benefit Guaranty Corporation*, 475 U.S. 211, 226-27 (1986); *Energy Reserves Group v. Kansas P. & L. Co.*, 459 U.S. (1983) 400, 413-14 (1983).

²⁰³ e.g. *ADF Group v. United States of America* (n 92); *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID No. ARB/99/2, Award, 25 June 2001.

²⁰⁴ *International Thunderbird Gaming Corporation v. United Mexican States*, UNCITRAL (NAFTA), Award, 26 January 2006 para.147. See also *Azurix Corp. v. Argentine Republic*, ICSID No. ARB/01/12, Award, 14 July 2006 paras.316-22; *Grand River Enterprises et al. v. United States of America*, UNCITRAL (NAFTA) Award, 12 January 2011 para.140; *Tecmed v. United Mexican States* (n 6) para.149.

²⁰⁵ *Metalclad v. United Mexican States* (n 14) para.107.

²⁰⁶ *Azurix v. Argentine Republic* (n 204) para.318.

court warned that the indirect expropriation doctrine ran a risk of including legitimate regulation by covering interferences with the ‘reasonably-to-be-expected benefit of property’.²⁰⁷

As many different elements should be considered, the protection of a reasonable and distinct expectation might vary on a case-by-case basis according to the specific factual context of the regulation. Of course, the expectation should be generated by the government in accordance with an appropriate understanding of the normative system of relevant contracts or actions.²⁰⁸ Another important index of legitimate expectation is changeability of the past regulatory circumstances in which the investment was made.²⁰⁹ In the *Oscar Chinn* case, the tribunal pointed out that the investor might have been aware of the changeable circumstances in which the river transport system could be heavily affected by the host states.²¹⁰ In other words, reasonably predictable changes in the law cannot constitute the violation of a legitimate expectation. In this context, the KORUS-FTA prescribes that the reasonableness of investment-backed expectations varies ‘in part on the nature and extent of governmental regulation in the relevant sector’.²¹¹ To be specific, the scope of a legitimate expectation might become narrower if the investor should have already recognized the fact that the host state exercises a strong regulatory power over the relevant business sector. For example, ‘an investor’s expectations that regulations will not change are less likely to be reasonable in a heavily regulated sector than in a less heavily regulated sector’.²¹² This is in accordance with recent NAFTA cases, like the *Methanex* case. Here, such legitimate expectations could not be recognized because it was found that the investor decided to make an investment in spite of the clear recognition of the fact that California maintains a heavily regulated environmental policy. This is evidenced by the investor’s previous actions in hiring a lobbyist to deal with such regulatory obstacles.²¹³

Some leading scholars argue that legitimate expectations originate from a general principle of domestic law which is shared by many other countries.²¹⁴ The logic of legitimate expectation also applies to Korean legal principles. Korean property law protects this expectation under a general principle of law: the principle of faith protection. In the *Green Belt* case, the Court held that the constitutional guarantee of property rights prevented a legal change that would suddenly

²⁰⁷ *The United Mexican States v. Metalclad Corporation* (n 18) para.99.

²⁰⁸ *ibid.*

²⁰⁹ Dolzer and Schreuer (n 49) p.105.

²¹⁰ *Oscar Chinn Case* (n 187) p.84.

²¹¹ KORUS-FTA Annex 11-B, footnote 18.

²¹² *ibid.*

²¹³ *Methanex v. United States of America* (n 16) Part IV, Ch. D p.9.

²¹⁴ Dolzer and Schreuer (n 49) p.104; Sornarajah (n 8) p.358.

decrease or decimate the value of the property owned. Further, the Court understood that the value of land would be guaranteed if such value was created on the basis of a faith that the government would maintain the pre-existing legal order.²¹⁵ Therefore, the governmental measures in the *Metalclad* case could be challengeable in Korean courts, as long as the claimant proves that the investment decision is based on reasonable faith regarding whether or to what extent the law will change.

iii) The character of government action

The tribunal of the KORUS-FTA should consider the character of government action, such as its objective and context.²¹⁶ The tribunal in *El Paso Energy International Company* case²¹⁷ held:

In sum, a general regulation is a lawful act rather than an expropriation if it is non-discriminatory, made for a public purpose and taken in conformity with due process. In other words, in principle, general non-discriminatory regulatory measures, adopted in accordance with the rules of good faith and due process, do not entail a duty of compensation.²¹⁸

Similarly, Article 11.6 of the KORUS-FTA recognises the legality of regulation as long as it is taken ‘(a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law and Article 11.5.1 through 11.5.3’. As a result, an investment tribunal is required to analyse the character of government action in order to review whether the measure in question was taken in conformity with the above mentioned conditions.

The *Saluka* tribunal discussed the character of government action in the process of reviewing a governmental measure, namely, the forced administration of a bank, which had been executed for the purpose of securing the stability of the national banking system.²¹⁹ The tribunal identified a police powers exception; here, the host state is allowed to undertake non-compensable expropriation in the form of ‘*bona fide* regulations’ which are purported to achieve ‘the general welfare’ ‘in a non-discriminatory manner’.²²⁰ This reasoning is supported by many legal

²¹⁵ 10-2 KCCR 927, 953, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

²¹⁶ KORUS-FTA Annex 11-B.3(1)(iii).

²¹⁷ *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011.

²¹⁸ *ibid* para.240.

²¹⁹ *Saluka Investment BN v. The Czech Republic*, UNCITRAL(Dutch/Czech BIT) Partial Award, March 17, 2006 para.275.

²²⁰ *ibid* p.255.

sources;²²¹ for example, the tribunal referred to Article 10(5) of the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens,²²² the United States Third Restatement of the Law of Foreign Relations in 1987²²³ and the 1967 OECD Draft Convention on the Protection of Foreign Property,²²⁴ which recognise the principle right to regulate property in the public interest in the context of the political or social ends of the sovereign state. This approach is not foreign to U.S. regulatory taking; notably, the *Penn Central* case scrutinised the character of the government measure in order to assess whether the relevant regulation ‘arises from a public program that adjusts the benefits and burdens of economic life to promote the common good’;²²⁵ further the court, through this examination, determined to uphold the regulatory taking if the regulation did not substantially advance legitimate state interest.²²⁶

In conformity with this general principle of international investment law, the KORUS-FTA has tried to guide an investment tribunal to analyse the character of a government measure in a specific way by reflecting some of the legal sources and doctrines found in various jurisdictions. Most interestingly, the KORUS-FTA attempts to incorporate the *special sacrifice doctrine*²²⁷ used by Korean constitutional theory to differentiate a compensation-not-required regulation from a compensation-required one. To be specific, the KORUS-FTA provides that in considering the character of a government action, the tribunal could analyze ‘whether the government action imposes a special sacrifice on the particular investor or investment that exceeds what the investor or investment should be expected to endure for the public interest’.²²⁸ This wording is very similar to the Korean *Green Belt* ruling, in which the Court recognized the expropriation-like effect in the exceptional case where a property owner is forced to endure disproportionately special or exceptionally severe burdens in comparison to the constitutional public obligations assumed by

²²¹ *ibid* paras.256-60.

²²² Louis B. Sohn and R. R. Baxter, ‘Responsibility of States for Injuries to the Economic Interests of Aliens: II. Draft Convention on the International Responsibility of States for Injuries to Aliens’ (1961) 55(3) *The American Journal of International Law* p.554.

²²³ American Law Institute, *Restatement of the Law, The Foreign Relations Law of the United States* (American Law Institute Publishers, 1987) Section 712, Comment g.

²²⁴ OECD, ‘Organisation for Economic Co-operation and Development: Draft Convention on the Protection of Foreign Property’ (1968) 7(1) *International Legal Materials* pp.124-26.

²²⁵ *Penn Central Transportation v. New York City* (n 174) 124.

²²⁶ *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980).

²²⁷ Nakryoon Choi and Hongshik Lee, *A Sectorial Assessment of a Korea-US FTA and Policy Implications for the Korean Economy* (Korea Institute for International Economic Policy, 2007) pp.126-27; Jeong (n 30) pp.123-24.

²²⁸ KORUS-FTA Annex 11-B.3(1)(iii).

other ordinary people in the public interest. This expropriation-like effect presents government action as effectively blocking any meaningful use of a property.²²⁹

A similar logic is also found in the U.S. taking doctrine,²³⁰ despite the Trade and Environment Policy Advisory Committee (hereafter 'TEPAC') criticising this concept by claiming that the doctrine of a special sacrifice is foreign to U.S. legal principles.²³¹ In the *Lucas* case before the U.S. Supreme Court, the plaintiff argued that the government prevented any construction of a habitable building on the coast line under its coastal protection plan. Here the Court described 'extraordinary circumstances' and 'a relatively rare situation' of taking in which the regulation 'denies all economically beneficial or productive use of land'.²³² In addition, the special sacrifice doctrine is compatible with the purposes of the taking clause. The basic precept behind the special sacrifice doctrine is that an individual's special sacrifice for public purposes should be compensated at the communal level once the individual loss surpasses the communal obligation that the public can be expected to assume.²³³ Similarly, the *Armstrong* case held that,

[T]he Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar the Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.²³⁴

The character of a government action could be determined by its objectives and context. This issue is associated with the 'legitimate public welfare objectives' that the government seeks to achieve through regulatory action. The 'legitimate public welfare objectives' of the KORUS-FTA include 'public health, safety, the environment, and real estate stabilisation'.²³⁵ In particular, this provision allows the government to take a measure 'to improve the housing conditions for low-income households'.²³⁶ This reflects the Korean situation in which unregulated land speculation has increased the cost of housing to such an unreasonable level that many low-paid people cannot afford to own houses or even to pay rent. In addition, Article 11.10 of the KORUS-FTA guarantees

²²⁹ 10-2 KCCR 927, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

²³⁰ Jeong (n 30) pp.123-34.

²³¹ Trade and Environment Policy Advisory Committee (TEPAC), 'The U.S.-Korea Free Trade Agreement, Report of the Trade and Environment Policy Advisory Committee (TEPAC)' (2007) p.3 <http://ustraderep.gov/assets/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Reports/asset_upload_file267_12791.pdf> accessed 15 April 2012.

²³² *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1017-18 (1992).

²³³ See generally Hee-Yol Kay, *Constitutional Law II* (Bagyeongsa, 2002) p.522.

²³⁴ *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

²³⁵ KORUS-FTA Annex 11-B.3(b).

²³⁶ *ibid.*

the regulatory power of the state to protect the environment in contrast to its protection of investment. Those clauses cover a significant portion of the constitutionally justifiable measures of the Korean government, such as environmental protection²³⁷ or public policy relating to housing supply.²³⁸²³⁹ Lastly, the tribunal and the respondent state could suggest other kinds of legitimate public welfare objectives because the enumeration of such objectives in the treaty text is not exhaustive. This conceptual flexibility could help a government to protect a minimum scope for the exercise of justifiable regulatory power.

Of course, in considering the character of government action one runs a risk of causing further uncertainty. Indeed, it is rare for the modern democratic state to restrict property for reasons other than in the public interest. Consequently, the police powers exception could be abused by respondent states seeking to avoid indirect expropriation claims.²⁴⁰ In this vein, the *Saluka* tribunal also seems to admit that this doctrine is not absolute enough to justify all kinds of property restriction taken under the pretext of the public interest.²⁴¹ In addition, the *S.D. Myer* tribunal attempted to both ‘examine the purpose and effect of governmental measures’.²⁴² Finally, it is necessary to specify how to consider all three factors in an appropriate way. In this context, the KORUS-FTA proposes the proportionality test, as illustrated in the following.

C. Proportionality principle

Annex 11-B.3(a) does not provide clear direction as to how to use the above-mentioned factors in treaty interpretation. Such guidance is elaborated in paragraph 3(b), which prescribes that regulatory actions do not constitute indirect expropriation as long as i) those actions are intended to protect legitimate public welfare objectives; and ii) those actions take the form of non-discriminatory regulations. Therefore, the first step of the tribunal’s review is to consider the characteristics of a government act in order to clarify that the alleged regulation is intended to pursue a legitimate public welfare objective and that it is designed to be exercised in a non-discriminatory way. After the first step, the tribunal should go on to review whether those regulations put the investor or the investment into a ‘*rare circumstance*’, which is prescribed in

²³⁷ The Constitution of the Republic of Korea (Korean Constitution) Article 35(1).

²³⁸ *ibid* Articles 35(3) and 122.

²³⁹ 13-1 KCCR 129, 137, 99Hun-Ma636, January 18, 2001. See also 10-2 KCCR 927, 969, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998 (separate opinion of Judge Lee, Young-Mo).

²⁴⁰ Sornarajah (n 8) p.375.

²⁴¹ *Saluka v. The Czech Republic* (n 219) para.258. See also *El Paso Energy v. Argentine Republic* (n 217) paras.234-36.

²⁴² *S.D. Myers v. Canada* (n 190) para.281.

Annex-B.3(b) of the KORUS-FTA. Passing the first step would not work in favour of the respondent state as long as the tribunal recognizes that the alleged regulation is involved in this rare circumstance. Here, the KORUS-FTA proposes a more detailed exemplary situation where ‘an action or a series of actions is extremely severe or disproportionate in light of its purpose or effect’.²⁴³ This leads the tribunal to review the proportionality between the adverse effect of a regulation and the public interests pursued by that regulation.

This interpretation is compatible with several recent international investment tribunal cases which pay attention to the principle of proportionality.²⁴⁴ In particular, the *Tecmed* and *Azurix* cases²⁴⁵ show one possible application of the proportionality principle by reference to the reasoning of the European Court of Human Rights.²⁴⁶ The *Tecmed* tribunal dealt with similar facts to the *Metalclad* case, ruling on a government refusal to renew a landfill operation permit. In this case, the tribunal scrutinised the severity of the regulation in order to establish that the effect of the government measure nearly led to the closure of the landfill operation.²⁴⁷ A relevant action in the public interest cannot be immune from the tribunal’s review as long as that action nullifies an investment effectively and completely.²⁴⁸ Therefore, the tribunal examined ‘whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investment’.²⁴⁹ Here, the tribunal applied the proportionality test that ‘[t]here must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure’.²⁵⁰ In this vein, the *El Paso Energy International Company* case held that a regulation should not cause unreasonable inference with the property, and that one example of unreasonable regulation

²⁴³ KORUS-FTA Annex-B.3(b).

²⁴⁴ Fortier and Drymer (n 169) pp.324-25; Jack J. Coe Jr and Noah Rubins, ‘Regulatory Expropriation and the *Tecmed* Case: Context and Contributions’ in Todd Weiler (ed) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May, 2005) pp.664-65; Xiuli Han, ‘The Application of the Principle of Proportionality in *Tecmed v. Mexico*’ (2007) 6(3) *Chinese Journal of International Law* pp.324-25; Sornarajah (n 8) p.395.

²⁴⁵ *Azurix v. Argentine Republic* (n 204); *Tecmed v. United Mexican States* (n 6).

²⁴⁶ e.g. *James and Others v. the United Kingdom*, 21 February 1986, §50, Series A no. 98; *Mellacher and Others v. Austria*, 19 December 1989, §48-56, Series A no. 169; *Pressos Compania Naviera S.A. and Others v. Belgium*, 20 November 1995, §38-44, Series A no. 332.

²⁴⁷ *Tecmed v. United Mexican States* (n 6) paras.115-17.

²⁴⁸ *ibid* para.121.

²⁴⁹ *ibid* para.122.

²⁵⁰ *ibid*. See also *Azurix v. Argentine Republic* (n 204) para.311; *Fireman’s Fund Insurance Company v. United Mexican States*, ICSID No. ARB(AF)/02/1, Award, 17 July 2006 para.176.

situations is when the regulation is disproportionate to the purposes of the host state.²⁵¹ Finally, the *LG&E Energy Corp.*²⁵² tribunal clearly held:

With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.²⁵³

Based on this standard, the *Tecmed* tribunal conducted a fact-based inquiry on the nexus between the public purpose of the government act and consequential effect of the regulation. The tribunal recognized that the operation of the investment neither impaired environmental protection and public health nor did it cause a genuine social crisis.²⁵⁴ Rather, the tribunal identified that the public authority issued a refusal of permit renewal in order to respond to community pressure in particular political and social circumstances.²⁵⁵ The tribunal attempted to decide whether this government response dealt with the relevant problems appropriately and rationally; in effect it analysed whether or not the governmental measure was proportionate to the adverse effect of this action.²⁵⁶ After careful analysis, the tribunal held that the community pressure precipitating the measure was not directly related to the activities referred to by the public authority as their reason for the revocation, finding that the relevant circumstances were not serious enough to require the refusal of the permit renewal.²⁵⁷ Indeed, the tribunal found that the community pressure was more directly related to relocating the landfill business, than the closure of its operations, the harmfulness of which had not been clearly evidenced.²⁵⁸ All in all, it held that the governmental action was not proportionate in the light of its purpose and effect if the measure were to lead to the closure of the business itself, despite the investor's efforts regarding the relocation commitment.²⁵⁹

The *Azurix* case provides another example of the application of the proportionality test.²⁶⁰ In this case, a U.S. investor won a bid for a 30 year concession for water distribution and sewerage

²⁵¹ *El Paso Energy International Company v. The Argentine Republic*, ICSID No. ARB/03/15, Decision on Jurisdiction, 27 April 2006 paras.240-43.

²⁵² *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006.

²⁵³ *ibid* para.195. See also *El Paso Energy v. Argentine Republic* (n 217) para.241.

²⁵⁴ *Tecmed v. United Mexican States* (n 6) para.124.

²⁵⁵ *ibid* para.127.

²⁵⁶ *ibid* para.132.

²⁵⁷ *ibid* paras.133-39.

²⁵⁸ *ibid* para.140.

²⁵⁹ *ibid* para.149.

²⁶⁰ *Azurix v. Argentine Republic* (n 204).

treatment through a privatisation project introduced by Argentina. After the business was in operation, the municipal authorities of Argentina took a series of betrayal measures after the public criticised the private company for charging unreasonable fees. These measures eventually forced the investor to file for bankruptcy, leading the claimant to argue that the government violated the BIT by interfering with the tariff regime and failing to comply with its obligation under the concession. The tribunal examined whether the public purpose existed within the measures, in addition to assessing their effects.²⁶¹ In the course of applying the proportionality test of the *Tecmed* case,²⁶² the tribunal conducted a fact-based inquiry of the action argued by the claimant. This inquiry focused on the investor's legitimate expectation,²⁶³ more specifically, whether those expectations were formed with a convincing understanding of the normative system applicable to the concession, and how severely the expectations were ignored to the extent that they constituted a deprivation of the property.²⁶⁴ The tribunal recognised that the actions of the local authorities politicised the concession agreement beyond the contractual rights of that agreement.²⁶⁵ It also found hostile attitudes and an intention to ignore the investor's rights on the part of the authorities.²⁶⁶ However, the tribunal assessed that the financial difficulties that the investor faced were not solely attributable to the government's actions and that some of the expectations of the governmental commitment to the concession were based on an unconvincing understanding of the relevant law and concession agreement.²⁶⁷ The tribunal eventually concluded that the extent of the impact of measures on the investment was not enough to constitute the expropriation.²⁶⁸ In particular, the tribunal pointed out that despite a series of state acts the investors maintained a significant portion of ownership in the investment.²⁶⁹

This is similar to the so-called 'Dolan-Nollan' test, which requires a court to examine the correlation between the public interest and the involved burden that the plaintiff should assume.²⁷⁰ The *Nollan* decision required the existence of a nexus between the regulation and its purpose; here, the Californian Coastal Commission required the dedication of an easement across the plaintiff's

²⁶¹ *ibid* para.311.

²⁶² *ibid*.

²⁶³ *ibid* paras.316-23.

²⁶⁴ *ibid* para.318.

²⁶⁵ *ibid* para.319.

²⁶⁶ *ibid* para.320.

²⁶⁷ *ibid* para.321.

²⁶⁸ *ibid* para.322.

²⁶⁹ *ibid*.

²⁷⁰ *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987). See also E. Thomas Sullivan and Richard S. Frase, *Proportionality Principles in American Law: Controlling Excessive Government Actions* (Oxford University Press, 2008) pp.74-80.

property as a condition of the approval of a rebuilding permit. The public authority in this case argued that this condition was intended to promote a legitimate state interest by dealing with a 'blockage of the view of the ocean',²⁷¹ which the plaintiff's building plan caused. The court admitted that the government has the authority to secure the public's view of the beach from the street.²⁷² However, the relevant regulation did not serve the purpose of securing the view of the beach, but rather only public access to the beach.²⁷³ The court eventually upheld the taking on the ground of an insufficient nexus between the regulation and its purpose.²⁷⁴ Following the *Nollan* case, the *Dolan* case added another standard to this test, namely rough proportionality. In that case, a city allowed an investor to expand onto property adjacent to a floodplain on the condition he or she created a public greenway and bicycle path. Here, the court upheld the nexus between the relevant condition and the public purpose of preventing flooding and traffic congestion.²⁷⁵ However, the court examined the reasonable relationship between the conditions of the development permit and the impact of the development.²⁷⁶ In other words, an individual property owner's suffering as a result of the imposition of the condition should be roughly proportionate to the public harm of the proposed land use.²⁷⁷ Based on this standard, the court held that the city had used unnecessary and excessive means, even if the same goal could have been achieved through an extant zoning requirement.²⁷⁸ In addition, the court pointed out that the city had suggested only a very vague possibility that the creation of a bicycle and pedestrian pathway would reduce traffic congestion.²⁷⁹

To summarise, a KORUS-FTA tribunal might take several steps in order to review the alleged breach of the indirect expropriation clause: first, the tribunal should decide whether the involved regulation protects legitimate public welfare objectives and whether it is implemented in a non-discriminatory way; and secondly, the tribunal is required to scrutinise whether the relevant regulation generates a situation that is disproportionate to the government's purpose in protecting the general welfare. Here the tribunal could use the reasoning of the *Tecmed* case. As such, a regulation should be considered in an arbitration, even if it protects legitimate public welfare, as long as it causes severe enough effects to close down the effective operation of an investment.

²⁷¹ *Nollan v. California Coastal Commission* (n 270) 828.

²⁷² *ibid* 836.

²⁷³ *ibid* 836-37.

²⁷⁴ *ibid* 837.

²⁷⁵ *Dolan v. City of Tigard* (n 270) 387-88.

²⁷⁶ *ibid* 388.

²⁷⁷ *ibid* 389-91.

²⁷⁸ *ibid* 393.

²⁷⁹ *ibid* 395-96.

Finally, the tribunal would hold a regulation as constituting an indirect expropriation when it could establish that the investor was suffering an inordinate burden by weighing the adverse effects against the public interest pursued.

A similar reasoning is found in the Korean *Green Belt* case; the court can order the government to take compensation-like measures when it finds a breach of the proportionality principle.²⁸⁰ In order to conduct a proportionality test, the court reviews whether the Green Belt policy pursues the public interest, which is considered to be a social obligation under Article 23(2) of the Korean Constitution. The Korean Court and the investment tribunal under the KORUS-FTA principally presume that the regulatory interference is non-compensable as long as it serves the public interest which is prescribed as a 'legitimate public welfare objective' under the KORUS-FTA and a 'social obligation' under the Korean Constitution.²⁸¹ Next, the Korean court examines how severe a burden the plaintiff has been forced to bear; specifically, whether the general application of the government regulation was implemented in a discriminatory way that imposed an unequal burden on a particular land owner. In international investment law, a regulation can constitute indirect expropriation when the general application of a regulation could affect the claimant in a discriminatory way.²⁸² Lastly, the court considers the proportional relationship between the public purpose and its effect. The investment tribunal also conducts a proportionality test; the regulation is less likely to be compensable where the public interest outweighs the private interests of investors.²⁸³

D. Meaning of 'prompt, adequate, and effective' compensation

The KORUS-FTA requires only 'payment of prompt, adequate, and effective compensation'.²⁸⁴ This provision reflects the so-called 'Hull formula' which was first proposed by the U.S. Secretary of State, Cordell Hull, in a dispute regarding the Mexican expropriation of property belonging to U.S. citizens. This formula has been heavily applied to determine the standard of compensation for expropriation under many investment treaties.²⁸⁵ It requires the host state intending to directly or indirectly expropriate property to make adequate payment of the fair market value for the loss in the property, promptly, without any undue delay, and effectively, in a

²⁸⁰ 10-2 KCCR 927, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

²⁸¹ Sornarajah (n 8) p.395 (in the perspective of international investment law).

²⁸² *ibid* p.396.

²⁸³ *ibid*.

²⁸⁴ KORUS-FTA Article 11.16.1(c).

²⁸⁵ See generally Sornarajah (n 8) pp.211-12 and pp.413-17.

convertible currency.²⁸⁶ Tribunals have held that the standard of adequate compensation refers to the full payment of fair market value.²⁸⁷

This is very similar to the standard for compensation for public interference under Article 23(3) of the Korean Constitution which requires *full compensation of the objective value of the interfered property*.²⁸⁸ Another similarity is the scope of full compensation, which in Korean law excludes profits or losses (e.g. any speculative surplus on the land) which are added to the property by the government action or intention;²⁸⁹ under Article 11.6.2(c) of the KORUS-FTA, compensation for the expropriation does ‘not reflect any change in value occurring because the intended expropriation had become known earlier’.

V. ENDURABLE OR REDUCIBLE SUBSTANTIVE DOCTRINAL GAPS

A. *Remaining specific gaps in substantive aspects of the doctrine*

This thesis has highlighted that there are more commonalities than might be expected between the property protection offered by the Korean Constitution and the investment protection conferred by the KORUS-FTA. Generally speaking, both systems pursue a balance between property rights and public regulatory power by adopting the proportionality principle. In addition, the KORUS-FTA’s proportionality test incorporates many legal elements from the two countries, such as the U.S. *Penn Central* doctrines and the Korean sacrifice doctrine. Nevertheless, one might still undeniably find several doctrinal gaps, as illustrated in the following sections.

i) Gap between just compensation and compensation-like measures

The Korean Constitutional Court is not clear about whether a breach of proportionality leads to the recognition of public interference. In fact, the concept of indirect expropriation is most similar to the public restriction of the Article 23(3) of the Korean Constitution, among other Korean legal concepts, in the sense that it requires just compensation even if a physical taking does not

²⁸⁶ Dolzer and Schreuer (n 49) pp.90-91 and pp.273-74.

²⁸⁷ e.g. *Biloune v. Ghana* (n 182) p.211; *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID No. ARB/96/1, Award, February 17, 2000 para.70. See also *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID No. ARB/84/3, Award and Dissenting Opinion, 20 May 1992 paras.179-244 (regarding issues relative to the calculation of compensation).

²⁸⁸ 7-1 KCCR 519, 519, 93Hun-Ba20, April 20, 1995; 11-2 KCCR 721, 729, 98Hun-Ba13, December 23, 1999.

²⁸⁹ 13-1 KCCR 932, 2000Hun-Ba31, April 26, 2000.

actually occur.²⁹⁰ However, the Korean Constitutional Court in the *Green Belt* case did not make it clear whether recognition of a severe burden on a property owner serves as a ground to consider the relevant regulation as an expropriation or a public restriction under Article 23(3) of the Korean Constitution. Instead, the Korean Court surmised that a disproportionate restriction of property is associated with a breach of the social obligation doctrine according to Article 23(2) of the Korean Constitution.²⁹¹ This ambiguous language remains a source of controversy in Korean property law, as seen in the previous chapter.

The *Green Belt* ruling just suggested that a breach of proportionality causes the government to assume an obligation not of the compensation of Article 23(3), but of compensation-like measures under Article 23(2). Here a compensation-like measure is not identical to the compensation required by Article 23(3) of the Korean Constitution. A judicial order for a compensation-like measure allows the government to consider many other alternatives to cure a disproportionate situation.²⁹² Firstly, the government does not have to pay more than the amount of money required to strike a balance between the public interest and the private right. Secondly, instead of paying monetary compensation at the full market value, this could make room for the public authority to invent less intrusive administrative actions. In terms of policy considerations, this doctrine of compensation-like measures could allow the government to avoid the incredible financial burden of direct full market value compensation.

The problem is that a breach of the proportionality test does not trigger an obligation of compensation under Article 23(3) of the Korean Constitution, but of a *compensation-like* measure under Article 23(2). As seen above, the KORUS-FTA adopts the Hull formula, which is similar to Article 23(3) of the Korean Constitution. Given that fact, a foreign investor is given an additional chance to challenge a government action on the basis that compensation remains unsatisfied because a Korean compensation-like measure does not necessarily meet the conditions of the just compensation prescribed in the KORUS-FTA. Suppose that the property of a foreign investor were to be severely restricted by a government regulation. The government, avoiding the full monetary payment of compensation, provides other administrative remedies like a compensation-like measure in accordance with the *Green Belt* ruling. The Korean Court would therefore recognize the

²⁹⁰ Hyeon-Chul Kang, 'Constitutional Compatibility of Investor-State Dispute (Issue Paper: 07-3)' (2007) p.37 <<https://www.klri.re.kr/kor/publication/pubReportTotalView.do?seq=4&gbn=F&typeCd=>> accessed 15 April 2012.

²⁹¹ 10-2 KCCR 927, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

²⁹² 10-2 KCCR 927, 929-30, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998; 11-2 KCCR 383, 418, 97Hun-Ba26, October 21, 1999.

regulation as justified as long as it includes a compensation-like measure to cure any disproportionality.²⁹³ However, the Korean government may be faced with a different perspective on the same regulation under the KORUS-FTA; a foreign investor could argue a breach of the indirect expropriation provision on the grounds of an absence of just compensation. In another case, a U.S. investor could raise a legal suit if the amount of money paid by the government to restore proportionality does not reach the fair market value to restore the value loss.

ii) 'Legitimate public welfare objective' and 'social obligation'

It is not clear whether the 'legitimate public welfare objective' of the KORUS-FTA is identical to the public goal of the Korean Constitution. For example, the government has argued that its Green Belt policy was established to prevent 'traffic or water supply problems that arise out of the expansion of a city, preserving healthy farming and a city's natural surroundings, leaving some lands unused inside the city, and making the urban space for disaster prevention'.²⁹⁴ This purpose may not be recognized during arbitration if a tribunal understands those purposes not to be directly related to public health, safety, the environment and real estate stabilization (improvement of housing conditions for low-income households), as per Annex 11-B of the KORUS-FTA.

In particular, there may be greater uncertainty as to whether the public concept of land could be accepted in international investment arbitration. Korean constitutional theorists and lawmakers have often argued for 'the public concept of land' based on Article 122 of the Korean Constitution. This puts greater weight on the state's social obligation by underscoring the public characteristics of land property with a focus on the role of land in promoting public welfare.²⁹⁵ In practice, the Korean Constitutional Court has denied the constitutionality of some statutes inspired by the public concept of land theory.²⁹⁶ However, the government often challenges the Court's negative attitudes by proposing land regulations based on the public concept of land, whenever land speculation emerges as a serious social issue. In this context, many policy makers and scholars argue that judicial attitudes on this point should change.²⁹⁷ Additionally, the Korean Constitution also admits the possibility that the government restrict land property under the public concept of land although

²⁹³ 16-1 KCCR 202, 226-27, 2001Hun-Ba80•84•102•10, 2002Hun-Ba26, February 26, 2004; 18-1(A) KCCR 1, 1-2, 2005Hun-Ba18, January 26, 2006.

²⁹⁴ Opinions of the Ministry of Construction and Transportation and the Ministry of Justice in 10-2 KCCR 927, 939-40, 89Hun-Ma214, 90Hun-Ba16, 97Hun-Ba78, December 24, 1998.

²⁹⁵ See generally Nak In Sung, 'The Guarantee of Property Rights and Legislation on the Concept of Public Land' (2007) 18 Administrative Law Journal pp.505-08.

²⁹⁶ 6-2 KCCR 64, 92Hun-Ba49, July 29, 1994; 11-1 KCCR 289, 94Hun-Ba37, April 29, 1999.

²⁹⁷ Sung (n 295) pp.523-24. See also Woo-Jin Lee, 'A Legal Study on the Reposition of Public Concept of Land Ownership – Centering around Reintroduction on the Land Excess-profits Tax Act' (2009) 34 Law Review (arguing for indirect regulation in the context of the public concept of land).

such restriction is somewhat limited. The Court has also justified a piece of legislation to levy tax on land excess-profit by reference to the public concept of land.²⁹⁸ Given this, it might be highly questionable if a KORUS-FTA tribunal will uphold those government actions as ‘legitimate public welfare objectives’.

B. Overall convergence between the Korean Constitution and the KORUS-FTA

Such doctrinal gaps are expected to be enduring and reducible for both a foreign investor and the Korean government in the current practice of both Korean law and international investment law. In other words, the extent of these doctrinal gaps is not expected to hinder the Korean government in achieving its own constitutional goals in usual situations too severely. Generally speaking, it is questionable that the Korean legal system is too poorly developed to protect foreign investment according to the global standards generally agreed upon by international investment lawyers. In addition, a tribunal would not accept unreasonable claims which have risk of making it difficult for the Korean government to fulfil its essential constitutional functions.

To take an example, the review process of a KORUS-FTA tribunal bears a striking resemblance to that of the Korean Constitutional Court. Let us suppose that a Korean government regulation causes an expropriation-like effect on an investor’s property in protecting the public interest. The Korean government would prepare a compensation-like measure in advance because it should avoid possible constitutional claims, in accord with the *Green Belt* ruling. As long as the Korean government takes appropriate measures under the Korean Constitution, an investment tribunal is unlikely to strike down the government regulation on unreasonable grounds.

Firstly, investment tribunals and the Korean court are relatively generous regarding the public purposes of a regulation. Of course, there is a possibility that a KORUS-FTA tribunal would deem the relevant regulations established in pursuit of a Korean constitutional goal as not belonging to the category of ‘legitimate public welfare objectives’. However, an arbitrator could flexibly expand the recognizable scope of the legitimate purpose of a regulation because the list of ‘legitimate public welfare objectives’ is not exhaustive.²⁹⁹ Concurrently, the Korean legal system is gradually showing more deference to individual property rights. In fact, as the Korean economy grows, it needs greater and more active participation by private actors nationally and globally. Nevertheless, Korean constitutional practice has not paid sufficient attention to private rights in

²⁹⁸ 11-2 KCCR 149, 171-73, 97Hun-Ba55, July 22, 1999.

²⁹⁹ KORUS-FTA Annex 11-B, footnote 19.

order to promote private investment. In other words, the Korean government has abused its regulatory rights by feigning public welfare.³⁰⁰ Meanwhile, the Korean Court has shown a very passive attitude towards expanding the scope of compensation-required government action. In light of this, critics argue that the emergent Korean legal system would be induced to pay greater attention to individual rights. They insist that the government would have to reconsider more indirect regulation, thus seeking to cause less interference with private interests in designing the regulations.³⁰¹ In this vein, the Korean courts have shown a meaningful orientation towards respect of individual property rights. To take the example of the public concept of land, many academic commentators argue that this concept should be adjusted by proposing a so-called ‘market-friendly public concept of land’ as Korean legal scholars argue that bogus public interests need to be carefully distinguished in order to protect the constitutional rights of property.³⁰² In addition, it is highly doubtful that property protection based on compensation-like measures could not satisfy U.S. investors. The Korean Court has, in separate opinions, expressed some very cautious but promising suggestions to make the amount and the nature of compensation-like measures under Article 23(2) of the Korean Constitution more closely identical to the just compensation of Article 23(3).³⁰³ Furthermore, one commentator argues that Korean legal practices need to become habituated to the global standard in the area of property protection.³⁰⁴

All things considered, the severity of the above-mentioned doctrinal gaps might be durable, and at least reducible in the future, both for a foreign investor and the host state where there is a broader convergence of property law. From a Korean perspective, a series of recent constitutional cases concerning property law seems to suggest that the level of property protection afforded to investors would not regress from the current level. To the extent that property protection is strengthened in the Korean legal system, the current practices of international investment law

³⁰⁰ Jee-Yeop Kim and Jong-Dae Jung, ‘A Comparative Study on the Land Uses System of Korea and the US with a Focus on Property Rights under the Constitution’ (2007) 42(4) National Land Plan pp.23-24; Kim and Kim (n 170) pp.28-29.

³⁰¹ Kwan-Ho Kim, ‘KORUS FTA and Indirect Expropriation: Implications for the Korea’s Property Rights Protection System’ (2007) 16(1) Journal of Regulation Studies pp.61-63.

³⁰² See generally In-Ho Choi, ‘A Study on the Public Role to Realize Market Oriented the Public Concept of Land Ownership’ (2007) 38 Public Land Law Review; Su-Weon Eom, ‘A Study on the Market-Friendly Public Concept of Land Use’ (2007) 38 Public Land Law Review; Yong Chang Kim, ‘Rethinking the “Public Use” Perspectives on Land Property Right in the Age of Neoliberalism’ (2007) 38 Public Land Law Review; Dong-Soo Lee, ‘Market-Based Public Concept of Land’ (2007) 38 Public Land Law Review (*Tojigongbeobyeongu*); Jae-Sam Lee and Sang-Taek Nam, ‘A Discussion on the Market-Friendly “Public Concept of Land”’ (2007) 38 Public Land Law Review; Young-Woo Lee, ‘A Study on Realization Ways of the Market-friendly Public Concept of Land Ownership’ (2007) 38 Public Land Law Review.

³⁰³ 15-1 KCCR 371, 399-402, 99Hun-Ba110•2000Hun-Ba46, April 24, 2003 (Justice Kwon Sung’s separate opinion arguing unconstitutionality).

³⁰⁴ Kim (n 301) p.64.

shows more respect for government regulatory power, especially in the area of public interests, such as the environment or human rights.³⁰⁵ In sum, it becomes gradually less likely that regulations that are considered to be legitimate laws in the national legal system constitute indirect expropriation at the level of international investment law.

VI. CONCLUSION: INERADICABLE RISKS UNDER THE KORUS-FTA

As discussed above, the current trend in the indirect expropriation doctrine shares many common substantive features with the Korean legal doctrine of property rights. First of all, an investment tribunal and a Korean court are required to tackle the same issue of how to draw a discrete line between a legitimate government action exercising sovereign power against abusive use of a property right and capricious authoritarianism against a protectable individual right. Secondly, both legal systems seem to solve this problem in a similar way, namely using a proportionality test. Of course, several gaps remain within this context; the factors that a tribunal considers in determining proportionality are not exactly the same as those taken into account by a Korean court. Nevertheless, this gap would not pose an unacceptable challenge to Korean public authorities or individual foreign investors in ordinary situations. Figuratively speaking, two cooks can concoct similar tasting dishes using slightly different ingredients under a similar recipe; one may sweeten the dish with maple syrup, the other with honey. A customer would not complain aggressively as long as the taste could satisfy her or his essential needs in an ordinary case. In the present context, a practitioner expects decisions by any of the other forums to secure similar or acceptable consequences, just as 'a rose by any other name would smell as sweet'.³⁰⁶ At minimum, indirect expropriation would not precipitate disastrous consequences for the national regulatory system.³⁰⁷

However, such doctrinal similarities between the national and international law cannot eliminate all relevant risks of conflict between a host state and a foreign investor. A conflict occasioning a disastrous consequence for the host state occurs unexpectedly and in unusual circumstances. Here, serious challenges for the Korean government take place not because of substantive differences in wording, but due to the operation of the treaty, i.e. the application

³⁰⁵ Sornarajah (n 8) pp.398-400.

³⁰⁶ Barry Appleton, 'Regulatory Takings: The International Law Perspective' (2002) 11(1) New York University Environmental Law Journal p.46.

³⁰⁷ Ibid.

procedure like Chapter 11 arbitration. Indeed, even if Korean law and international investment law had shared the exact same doctrines on property protection and restriction, there would remain the possibility of conflict between a foreign investor and the Korean government.

The reason for this is that all the actors in the global investment field are fair-weather friends; in peaceful periods, a host state will attract and protect foreign investment in order to foster the national economy. Concurrently, a foreign investor will cooperate with the host state because investment cannot be profitable without hospitable treatment from the government. Although a minor conflict could occur, a foreign investor would prefer a national remedy because investor-state arbitration costs a lot of time and money. In a sense, a U.S. investor might feel comfortable with a Korean national remedy, given that Korean legal practice and academic discussion have taken a great deal from U.S. property law and other developed countries.

However, this kind of friendship ends where the ultimate substantive goals of a host state and foreign investor can no longer be compromised. This is because the two actors operate principally according to their own rationalities; for instance, the host state works in order to win the next election, whereas the private foreign investor pursues its economic interests. Therefore, they are cooperative only to a certain limited extent. Suppose that Walmart were to dominate the distribution industry in a way to ruin small and medium retailers in Korea. If this situation caused such public concern that could affect the next election, the foreseeable political benefits of echoing such public criticism could overwhelm the extant political benefits of attracting the investment.

This is the point at which the Korean government starts to think of intervening in the market in accordance with Article 119(2) of the Korean Constitution.³⁰⁸ For example, the Korean National Assembly recently amended the Distribution Industry Development Act in order to regulate the uncontrolled expansion of supermarkets. Of course, a foreign investor would be amenable to Korean public policy as long as government action is not expected to seriously harm his or her own economic benefit. This cooperation is also based on an economic rationality in the sense that neglecting such public concerns has risks of damaging Walmart's reputation resulting in tacit hostility from the host state and its customers. However, the investor will lose this self-control when

³⁰⁸ The Korean Constitution, Article 119 (2):

The State may regulate and coordinate economic affairs in order to maintain the balanced growth and stability of the national economy, to ensure proper distribution of income, to prevent the domination of the market and the abuse of economic power and to democratize the economy through harmony among the economic agents.

forced to suffer apparently unacceptable burdens to the point that he or she is unable to continue the business.³⁰⁹

This is the juncture at which the foreign investor starts to think about engaging the investor-state arbitration procedure. Here, Chapter 11 arbitration is invoked not in the usual 99% of situations but in the unusual 1%. In such an unusual situation, the Korean government, despite impressive textual similarities, will not eliminate the risk of an investment claim on constitutionally justifiable government regulations. The reason is that legal conflicts happen not because of textual differences but because of interpretative disagreements. To take an example of a constitutional claim at the national level, a plaintiff can sue the government even though both parties share the same constitutional text. In other words, constitutional claims arise due to differences in the interpretation of textual meaning between the parties; initially, the government takes action on the basis of an interpretation that this very action is constitutionally permitted. Nevertheless, the plaintiff contends that the government's reading is wrong by arguing that the action involved violates the constitution. Similarly, even had the KORUS-FTA been drafted to ensure that its expropriation provisions were identical to Korean constitutional law, a foreign investor and the Korean government can still interpret the same text in different ways to further their own interests. For instance, suppose that the Korean government takes a particular government action based on the assumption that this very action protects the 'legitimate public welfare objectives' of Annex 11-B.3(a)(iii) of the KORUS-FTA. Regardless of the government's interpretation, a foreign investor could still sue by interpreting the relevant provisions so that the government action is not associated with 'legitimate public welfare objectives'.

If such a conflict in an extreme case were resolved within the national system, the national government would face less risk as long as its measures are taken in accordance with Korean constitutional principles and legal sources. In relation to the national remedies available to the foreign investor, one could suppose many different situations. Firstly, if the investor relied only on relevant national legal sources, such as Korean Constitution or national law (Situation (a)), the national court would conduct a proportionality test in accordance with the *Green Belt* doctrine. In this situation, the Korean government can secure its regulatory power as long as the measure is

³⁰⁹ Before the amendment of the Distribution Industry Development Act, the UK government officially expressed concerns on the behalf of U.K. investors that this regulation could serve as a trade barrier and send a 'wrong signal' of protectionism. See Jin-Seo Cho, 'UK Presses Korea to Drop Supermarket Law' *The Korea Times* (2 November 2010) <http://www.koreatimes.co.kr/www/news/biz/2010/11/123_75648.html> accessed 15 April 2012. Unlike U.K. investors, who must ask their government to raise a voice, U.S. investors can use other tools to express their complaints against Korean regulations in unusual cases through Chapter 11 of the KORUS-FTA.

taken according to the Korean constitutional doctrine. Protection of both the foreign investment and the regulatory power is not guaranteed beyond the constitutionally justifiable scope. Secondly, a U.S. investor attempts to challenge a governmental measure before the Korean courts by questioning a breach of the KORUS-FTA clauses, or a violation of the Korean Constitution (Situation (b)). Whether the court will consider the KORUS-FTA depends on the context in which the governmental measure is taken. Situation (b) will ramify into several possible scenarios. Firstly, if the measure is based on an administrative ordinance or rule, or municipal ordinance subordinated to an ordinary legislative statute, the court will review whether the measure violates the KORUS-FTA (Situation (b)-1). Secondly, if the measure is taken in accordance with a legislative statute which is equivalent to the treaty under the Article 6(1) of the Korean Constitution, the national court will recognise the applicable law according the general principle of a conflict of norms (Situation (b)-2); for example, a recent case before the Korean Supreme Court held that the Convention for the Unification of Certain Rules relating to International Carriage by Air treaty as *lex specialis* prevails over the Korean Civil Act and the Commercial Act as *lex generali* in the respect of international air carriage.³¹⁰ Nevertheless, the Korean courts have not established a consistent doctrine to resolve conflicts between national law and international treaties. Thus, the national application of the KORUS-FTA remains dependent on the specific context of the case and the nature of the national law.³¹¹ If a national court did not recognise the KORUS-FTA as an applicable law in Situation (b)-2, it would review the relevant measure according to the national law proposed by the government – the foreign investor would naturally lose as long as the government took the measure legally. Eventually, the only choice available to the foreign investor would be to ask the ordinary court to request a constitutional review by questioning the constitutionality of the relevant national law. This eventually leads to Situation (a). On the other hand, if the court recognises the KORUS-FTA as an applicable law, it will review the measure in the same way as in Situation (b)-1; namely, it would need to interpret the KORUS-FTA text. When the Korean court applies the indirect expropriation clauses of the KORUS-FTA, it may apply a similar methodology to that of the international investment tribunal, which is required to assess whether the public welfare of the relevant measure is proportionate compared to the adverse impact on the property according to the Annex 11-B of the KORUS-FTA. However, the Korean court would articulate the ordinary meaning of the relevant KORUS-FTA clauses *by referring to national legal sources*. Thus, the Korean court would cite Korean legal decisions rather than previous investment arbitration decisions when it is unable to gain a meaningful understanding from the text itself. The investment

³¹⁰ Supreme Court of Korea Decision 2001Da67164 Declared July 22, 2004.

³¹¹ Nam and others (n 56) pp.388-91.

tribunal and Korean national court would concur as long as the fundamental values of two systems are negotiable or compatible. However, using a national remedy in an unusual case could make a significant difference when compared to using Chapter 11 arbitration. The Korean judiciary is naturally independent from any abuse of Korean regulatory power because Korean courts, especially the Constitutional Court, have established their authority by garnering public support in fighting against inappropriate political influence.³¹² Therefore, both a foreigner and a Korean national are protected if the Korean government exercises its power beyond its constitutional limits. This analysis leads to another assumption that the Korean court operates within the general values of constitutional principle, including the social state, which is approved by the Korean people. In other words, the Korean judicial system is accountable not to the executive branch but abstractly to the national people. At the same time, the proportionality test is not a firmly fixed mathematical formula stipulating a specific factual inquiry. In addition, Article 16 of the Korean Trade Procedure Act prescribes that no clause of a trade treaty shall be interpreted in such a way as to infringe upon the legitimate economic rights and interests of Korea. Therefore, national remedy logically entails the possibility that a Korean court might support a national measure by understanding proportionality differently from the general stream of international investment law in the rare but extreme cases in which investment disputes often occur.

On the other hand, a nation-state cannot not maintain tight control over legal conflicts, as long as it delegates its sovereign power of conflict resolution to an investment arbitration mechanism by agreeing to consent to arbitration. In relation to a conflict resolution, the investor-state arbitration mechanism produces its own rules to interpret the treaty text. The investment tribunal has principal authority to interpret the treaty text once the treaty itself is concluded. Of course, the investment tribunal could expand the category of 'legitimate public welfare objectives' in order to avoid a possible conflict with national public goals. However, it is the tribunal that has the final discretion over whether to expand this concept. Here the tribunal will be inclined to refer to the independent rules of interpretation unless the treaty text or an interpretative statement from the KORUS-FTA Joint Committee specifies another meaning. Those independent rules are developed through the accumulation of other previous arbitration decisions without any direct influence from the nation-states. Of course, current international investment rules stays within tacit sympathy with common legal doctrines found in many other countries. Nevertheless, individual nation-states cannot directly control the general future direction of international investment law as they cannot secure doctrinal affinity once the indirect expropriation doctrine launches its own autonomous path

³¹² See Chapter II. Part II.

and diverges from national law. For example, there is circumstantial evidence that the initial development of indirect expropriation was influenced by the regulatory taking doctrine of the U.S. Supreme Court.³¹³ However, in investment tribunals this doctrine has been developed in a manner that was relatively distant from the U.S. development path of regulatory taking resulting in its use to attack U.S. regulations established under the U.S. regulatory taking doctrine, as seen in many NAFTA cases. As such, arbitration may be more likely to develop an interpretative rule of 'legitimate public welfare objectives' by citing previous investment arbitration decisions, rather than Korean or U.S. court cases. Consequently, despite the rewording of the indirect expropriation provision in the treaty, the Korean government still suffers the risk of uncertainty or unpredictability. As a result, in practice the nation-state must consider transnational mechanisms and their substantive rules whenever it makes a public policy proposal.

In this context, some commentators point out that international investment law has developed into an autonomous system that goes beyond the state's original intentions. For example, critics of 'New Constitutionalism' argue that the autonomy of international investment law exercises a disciplinary effect of de facto higher law over individual nation-states and their legal systems, just as a national constitution prevails over its subordinate ordinary laws at the national level.³¹⁴

Of course, a transnational mechanism can be established or rejected by the formal, legal implementation of a nation-state's political intentions.³¹⁵ As long as a new world government does not emerge, few transnational mechanisms can operate without the aegis of sovereign state power. The current global investment system was not formed until nation-states formally delegated their own powers to transnational mechanisms. For example, many nation-states agreed to create institutional foundations for investor-state arbitration through multilateral treaties such as the ICSID Convention. Concurrently, State Parties to the KORUS-FTA consent to arbitration over any

³¹³ Actually, the Iran-US Claims Tribunal refined the jurisprudence of taking law in international investment law, and many of arbitrators in the Tribunal were influenced by and educated in the American legal context. Although this link is quite arguable and tangential, it is hard to deny that the reasoning of many international investment arbitrations seems to be indirectly or directly susceptible to various national legal traditions and philosophies. See Sornarajah (n 8) pp.364-76.

³¹⁴ David Schneiderman, 'Investment Rules and the New Constitutionalism' (2000) 25(3) *Law & Social Inquiry*; David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge University Press, 2008). See also David Schneiderman, 'NAFTA's Takings Rule: American Constitutionalism Comes to Canada' (1996) 46(4) *The University of Toronto Law Journal*; Stephen Gill, 'New Constitutionalism, Democratisation and Global Political Economy' (1998) 10(1) *Global Change, Peace & Security*.

³¹⁵ Gus Van Harten, 'Investment Rules and the Denial of Change' (2010) 60(3) *University of Toronto Law Journal*.

relevant dispute raised in the context of a treaty violation.³¹⁶ In light of its constitutional law, the sovereign state can allow its own judicial body to resolve a dispute between a foreign investor and a state organ within its own territory. Nevertheless, the Korean government consents to arbitration in KORUS-FTA disputes with foreign investors, which entails handing decision making to an independent tribunal outside Korean jurisdiction. Constitutional theory understands this practice as ‘international delegation’, where the state allows international institutions to take up a function which the sovereign state is traditionally presumed to hold.³¹⁷ In any case, it is hard to say that all kinds of international delegation under the KORUS-FTA are absolutely unconstitutional in any circumstance. It would be an exaggeration to claim that the Korean government through Chapter 11 arbitration gives up all sovereign powers. State parties retain formal rights to amend or even withdraw from treaties such as the KORUS-FTA and ICSID Convention.³¹⁸ In addition, the tribunal should not interpret the treaty text or any interpretative statement beyond the State parties’ intentions.

Such an analysis broaches the following question: why do nation-states voluntarily tie their own hands through the over 3,000 investment treaties despite such unavoidable risks, even if there are many other alternatives? For instance, national courts could handle conflict resolution regarding the interpretation of indirect expropriation. They could then interpret the relevant treaty text in accordance with Korean constitutional doctrine if there is a conflict between international and national rules. If so, the executive branch would not need to be subject to any legal source other than Korean law. Alternatively, the nation-state could maintain national control over legal conflicts through the use of state-to-state dispute settlement after exhaustion of the local remedies, as seen in the US-Australia FTA.³¹⁹ Nevertheless, the Korean government chooses to rely on the system of investor-state arbitration in order to deal with dispute settlement. Regarding this policy choice, some Korean critical activist groups and the opposition party argue that Korean trade policy makers

³¹⁶ KORUS-FTA Article 11.17.

³¹⁷ See generally Curtis A. Bradley, ‘International Delegations, the Structural Constitution, and Non-self-execution’ (2003) 55(5) *Stanford Law Review*; Edward Swaine, ‘The Constitutionality of International Delegations’ (2004) 104(6) *Columbia Law Review*. See also Louis Henkin, *Foreign Affairs and the United States Constitution* (Clarendon Press, 1996) pp.247-73; Lori Fisler Damrosch, ‘Sovereignty and International Organizations’ (1997) 3(2) *University of California Davis Journal of International Law and Policy*; George A. Bermann, ‘Constitutional Implications of US Participation in Regional Integration’ (1998) 46 *American Journal of Comparative Law Supplement*; Brian F. Havel, ‘The Constitution in an Era of Supranational Adjudication’ (1999) 78(2) *North Carolina Law Review*; Julian G. Ku, ‘The Delegation of Federal Power to International Organizations: New Problems with Old Solutions’ (2000) 85(1) *Minnesota Law Review*.

³¹⁸ Harten (n 315).

³¹⁹ See generally William. S. Dodge, ‘Investor-state Dispute Settlement between Developed Countries: Reflections on the Australia-United States Free Trade Agreement’ (2006) 39(1) *Vanderbilt Journal of Transnational Law*.

are captured by a neo-liberal model or are puppets of American imperialism.³²⁰ This analysis logically proposes as an alternative, enlightenment or the politics of resistance which smashes the global setting that impairs national interests.

Even if such a critical analysis were partly true, it cannot show the entire picture regarding the rationale behind accepting the transnational mechanism. Of course, the risk for the U.S. government is relatively less than for the Korean government because the KORUS-FTA text incorporates more U.S. national legal doctrine than Korean. Nevertheless, the American government is also not completely immune from investor-state arbitration, as the TEPAC noticed.³²¹ At the same time, a foreign investor will also endure some degree of risk regarding the establishment of investment and unfamiliar legal circumstances in the foreign state. Nobody could deny the existence of such risks because the investment tribunal does not always work in favour of investors; the fundamental principle of international investment law is to strike a balance between the private interests of foreign investors and the justifiable regulatory power of the host state. All things considered, all actors in the global investment field share greater or lesser degrees of risks – although the risks relative to investment practices are unfairly distributed.

In this regard, the following Chapters IV and V will touch upon more profound questions within a theoretical framework to describe the broader picture of the global investment field: why do all the actors in the global investment field voluntarily share such risks by relying on the global investment legal system? Of particular concern to this thesis, what kinds of benefits could the nation-state enjoy through this mechanism in exchange for the corresponding risks? Is there any alternative to the legal system to allocate such risks in a fairer way? Specifically, what is the alternative for the nation-state to palliate unjustifiable, redundant risks on the one hand, and expand justifiable, requisite benefits in this global setting, on the other?

³²⁰ See generally Gi-Bin Hong, *Invest-State Claim* (Nogsaekpyeongnonsa, 2006); Gi-Ho Song, *Handbook of the KORUS-FTA: A Commentary of the KORUS-FTA for Government Officials* (Noksaengpyeongnonsa, 2007).

³²¹ See generally Trade and Environment Policy Advisory Committee (TEPAC), ‘Supplemental Statement Further Elucidating the TEPAC Majority’s Views Regarding Expropriation Concerning The U.S.-Korea Free Trade Agreement, Report of the Trade and Environment Policy Advisory Committee (TEPAC)’ (2007) <http://ustraderep.gov/assets/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Reports/asset_upload_file267_12791.pdf> accessed 15 April 2012.

CHAPTER IV

THE EMERGENCE OF A GLOBAL INVESTMENT LEGAL SYSTEM IN THE GLOBAL INVESTMENT REGIME

I. INTRODUCTION

As discussed in the previous chapter, a substantive doctrinal convergence between two legal systems cannot eliminate all latent risks caused by indirect expropriation claims. In this context, this chapter proposes a theoretical framework to explain the rationale which drives the nation-state to be voluntarily involved in the global mechanism of investment law despite its ineradicable risks. In order to do so, this thesis employs Teubner's concept of 'global law' to the global investment field in the context of the systems theory.¹

From this perspective, the chapter starts by analysing globalisation as providing the setting in which the current investment field is operating. As Part II of this chapter describes, systems theory defines globalisation as a process of functional differentiation, where world society is transnationally sectorialised into various autopoietic sub-societies according to their own innate functions taken for the sustainability of social communications. As those sub-societies compete and cooperate around common global issues, the interactions among the sub-societies are observable through interplays among the actors that represent corresponding sub-societies. Eventually, such forms of cooperation and conflict produce various communicative spheres which Teubner defines as a global regime. This theoretical framework can be used to explain the dynamics of the formation of the global investment regime (hereafter 'GIR') as a grand but temporary process of bargaining by global actors as functionally differentiated autopoietic sub-societies emerge in the course of globalisation in the global investment field – this thesis pays particular attention to the participation of the nation-state in this GIR.

¹ Here, the terms 'global law' and 'global legal system' are basically interchangeable because systems theory understands that the law can exist only in the form of a 'system', as will be discussed in this chapter.

Part III points out that this global regime is destined to vanish at the embryonic stage if it cannot manage conflicts in a stable way. Therefore, the GIR is also vulnerable to external impacts in the future, and global investment law or global investment legal system (hereafter ‘GIL’) is gradually required to cure the instability of the GIR over time. This is the point at which the development of a global regime gradually requires law to serve a greater function in stabilising the normative expectations of all regime members over time. Part III shows that this function can be fulfilled due to the autopoietic nature of the legal system. If one applies Teubner’s understanding of autopoiesis to global law, global law does not exhibit the perfect type of autopoiesis. However, this thesis shows that the partiality of autopoiesis does not interrupt global law from fulfilling the function of law. In turn, Part IV points out that global law can be called a legal system as long as it can fulfil the function of law, despite its partial autopoiesis. Global law protects the robustness and effectiveness of the regime by making it reflexive to the long-term benefits of relevant actors on one hand and protectable from challenges intended to gain short-term benefits, on the other hand. On the basis of this analysis, the thesis proposes two essential elements of the global legal system in its functionalist aspects – namely, participation and independent dispute settlement. If one finds these two elements to exist, one can say that some degree of autopoiesis is starting to emerge, and thus a given normative system can be recognised as a legal system, because these two elements of the legal system are sufficiently present to fulfil the function of law successfully. Within this framework, this chapter concludes that GIL is emerging as one example of global law by showing that these two elements of law exist in GIL.

II. THE GLOBAL INVESTMENT REGIME AS AN EXAMPLE OF A GLOBAL REGIME

A. Rudimentary logic and the assumption of global regime formation

The global regime, as an issue-driven communicative network, is a result of competition and cooperation among states and non-state actors to deal with common global issues. In fact, in attempting to understand the same issues in ways that expand their own interests, actors in the global field are competing with each other. Global actors tend to act so indifferent of one another that they do not consider what result one actor causes for another operating according to a different logic. What is worse, they attempt to dominate each other under their own rationality. Notably, the expansion of the global economic system prevails over other social values such as public health or environmental protection. Nonetheless, each global actor in this closely connected world cannot achieve an intended goal without the voluntary cooperation of other actors. Such mutual

indifference and severe competition increase the risk of self-destruction which will destroy this closely connected world as a whole. However strong the global economy is, it could not survive extreme political upheaval or public resistance. At the same time, the collapse of the economic system would certainly influence the political and public health system in turn. Finally, fear of the worst possible scenario drives each stakeholder in the global investment field to make compromises to secure long-term benefits and concede short-term losses.

Many political science theories concerning the organisation of the nation-state provide fruitful insights for understanding the underlying logic of global regime formation, even if those theories are not directly applicable to global regime formation, as will be discussed in the following sections. For example, the formation of a global regime is reminiscent of the core idea of social contract theory; individuals unite and establish a society to avoid a state of anarchic chaos characterised by naked violence or conflict. In the end, individuals delegate their sovereignty to the state authority as, in exchange, the government promises to protect these individuals under a certain order. Social contract theory, especially Locke's theory, explicates the idea that the rationality of human self-interest propels individuals to give up their absolute rights voluntarily in order to achieve the long-term benefits of a political or economic order.² This logic can be seen in the formation of order in international societies. For example, even if it cannot be directly applied to the international perspective, the domestic analogy applies the core logic of social contract theory to international relations by replacing individual people with individual states.³

Against such an intellectual background, the international regime theory, developed in the international relations scholarship, explains that individual sovereign states voluntarily delegate their absolute powers to global entities. The concept of a regime was introduced in order to illuminate what makes competing individual nation-states agree to cooperate without a dominant coercive power.⁴ Initially, regime theory was developed in the post-Cold War period, when superpowers such as the U.S. or the U.S.S.R could no longer control individual states. In other words, despite the absence of a conspicuous central controller, an order has developed to guide

² See generally John Locke, *Two Treatises of Government* (Published 1698, Mark Goldie ed, Everyman, 1993).

³ See generally Hidemi Suganami, *The Domestic Analogy and World Order Proposals* (Cambridge University Press, 1989); Hedley Bull, *The Anarchical Society: A Study of Order in World Politics* (Palgrave, 2002).

⁴ See generally Stephen D. Krasner, 'Structural Causes and Regime Consequences: Regimes as Intervening Variable' in Stephen D. Krasner (ed) *International Regimes* (Cornell University Press, 1983); Stephen D. Krasner, *Power, the State, and Sovereignty: Essays on International Relations* (Routledge, 2009).

competing states towards cooperation on universal issues, like environmental protection and terrorism.

Finally, the rudimentary framework of international regime theory could be applicable to the globalised world from a systems theory perspective. In international relations scholarship, the focus of regime theorists has been on the nation-state. In comparison, actors in a systems theory application of regime theory extend beyond state actors to include non-state actors that represent the rationalities of social systems such as the economy or public health. This theoretical construction is based on the assumption that the world is *per se* an autopoietic social system consisting of competing autopoietic sub-systems. In this context, the research described at the outset briefly attempts to sketch the outline and core concepts of systems theory in order to reconceptualise the global regime as the result of interplays between these sub-systems.

B. Emergence of autopoietic social systems

i) Concept of autopoiesis as self-referential logic

Systems theorists consider society to be an autopoietic social system comprised of communications.⁵ An autopoietic system⁶ produces and reproduces its own elements, operations, structures and boundaries. In other words, the system produces its own organisations in which components interact with one another in the circular process of the system itself and continuously engender other inter-systemic components required for the conservation of the system.⁷ Autopoiesis does not make a system self-sufficient because no system can exist without contributions from its environment.⁸ Certainly, an autopoietic system is required to be cognitively

⁵ Niklas Luhmann, 'The Unity of the Legal System' in Gunther Teubner (ed) *Autopoietic Law: A New Approach to Law and Society* (Walter de Gruyter, 1988) p.18.

⁶ Initially, the term autopoiesis was coined by the Chilean neurobiologists Humberto Maturana and Francisco Varela. In fact, Maturana came up with this neologism consisting of the Greek components *auto* (self) and *poiesis* (production) in order to describe the common features found in the organisation of all living systems. See Humberto R. Maturana and Francisco J. Varela, *Autopoiesis and Cognition: The Realization of the Living* (D. Reidel, 1980) p.xvii; Humberto R. Maturana, 'Autopoiesis' in Milan Zeleny (ed) *Autopoiesis: A Theory of Living Organization* (North Holland, 1981); Niklas Luhmann, *Einführung in die Systemtheorie* (Car-Auer-System Verlag, 2002) pp.110-11. See also John Mingers, *Self-producing Systems: Implications and Applications of Autopoiesis* (Plenum Press, 1995), pp.9-17. See also Michael King, 'The Construction and Demolition of the Luhmann Heresy' (2001) 12 *Law and Critique* (regarding critical analysis over various understandings of Luhmann's idea).

⁷ Georg Kneer and Armin Nassehi, *Niklas Luhmanns Theorie sozialer Systeme: eine Einführung* (W. Fink, 2000) pp.48-49. See also Gunther Teubner, 'Autopoiesis in Law and Society: A Rejoinder to Blankenburg' (1984) 18(2) *Law & Society Review* pp.292-93; Gunther Teubner, *Law as an Autopoietic System* (Blackwell Publishers, 1993) p.22.

⁸ Niklas Luhmann, *Die Wissenschaft der Gesellschaft* (Suhrkamp, 1992, 1990) p.30.

open because it needs to maintain exchanges with its environment or with other systems, just as a biological cell exists by absorbing water and heat from the environment.⁹ Nevertheless, autopoiesis means operational closure to the environment, so that the system is not simply the receiver, but is the regulator (or selector) of environmental influences; for example, the exchange of energy and matter between a cell and its environment is controlled entirely in accordance with the internal state of the cell. That is to say, an autopoietic system chooses to accept the elements required for its organisation only by reference to the internal selectivity of the system.¹⁰ Seen from this point of view, the concept of self-reference might be one of the most appropriate qualifiers to describe the feature of autopoiesis. Furthermore, the system reconstructs accepted external elements into its own internal elements in its own way, so that these internally constructed elements gain totally different emerging properties from those they had in the environment.

ii) Communication as a building block of society

The logic of self-referential operations in an autopoietic system may become more convincing when one considers communication as a conceptual building block of a social system. Even if the concept of autopoiesis is applicable to biology and psychology, many commentators, even autopoietic theorists in natural science, are reluctant to directly apply the concept of autopoiesis to the social context.¹¹ Here, social systems theorists make theoretical alterations by replacing autopoiesis among cells or humans with autopoiesis among communications. In other words, autopoiesis works in the social system only if one considers communications as the conceptual building blocks of society, rather than other material things such as cells or humans.¹²

Moreover, systems theory raises ontological questions as to what really exists in society. According to (social) systems theory, production is not associated with materialistic connotations because it is a *meaning* that is produced and processed within the social system.¹³ In relation to the production of meanings, the meaning of a certain being is defined or produced differently according

⁹ Kneer and Nassehi (n 7) p.50.

¹⁰ *ibid* pp.50-51.

¹¹ Niklas Luhmann, 'The Autopoiesis of Social Systems' in R. Felix Geyer and Johannes van der Zouwen (eds), *Sociocybernetic Paradoxes: Observation, Control and Evolution of Self-steering Systems* (Sage, 1986) p.172; Gunther Teubner, 'Evolution of Autopoietic Law' in Gunther Teubner (ed) *Autopoietic Law: A New Approach to Law and Society* (Walter de Gruyter, 1988) p.221; Niklas Luhmann, *Essays on Self-reference* (Columbia University Press, 1990) p.176; Teubner (1993) (n 7) pp.28-29; Niklas Luhmann, *Die Gesellschaft der Gesellschaft* (Suhrkamp, 1997) pp.24-35. See also Kneer and Nassehi (n 7) p.55; Michael King and Chris Thornhill, "'Will the Real Niklas Luhmann Stand up, Please". A Reply to John Mingers' (2003) 51(2) *The Sociological Review* p.279.

¹² Michael King, 'The "Truth" about Autopoiesis' (1993) 20(2) *Journal of Law and Society* pp.219-20.

¹³ Luhmann (1990) (n 11) pp.21-79.

to the communicative contexts in which the being is situated. Although a specific human as a biological organism or as an individual psychic subject makes essential contributions to the production of meanings, they are replaced by or vanish into the temporal flux of social communications.¹⁴ They are originally anonymous because they can be specified only in particular communicative contexts. For example, George Bush, as one of 6 billion biological and psychological beings in the world, can be replaced with Barack Obama or some other person at any time according to the political rationality that is related to the production of collectively binding decisions. There is no necessary logical reason why that particular human being has to be George Bush beyond a specific communicative context. A human being can make a play of being Barack Obama as a Harvard Law School graduate, a lawyer, a former Chicago Law School professor, and the first African-American U.S. President, because he was and is all of these things – coincidentally or randomly – in particular communicative contexts. Likewise, social structures and institutions constantly change in accordance with their communicative contexts. The parliamentary system of government can be changed into a presidential system at any time according to political rationality. Who or what institution will be chosen at a particular time and place ultimately depends on which person or which institution will gain public support. Conversely, any changes in institutions or personnel within a communicative system cannot alter the social system's fundamental rationality which serves as a rationale for these very same institutional and personal changes. Seen from this point of view, what is most meaningful to society is communication, because only communication can make society decide whether to introduce the various meanings of biological and psychological being into society itself.¹⁵

¹⁴ Daniel Chernilo, *A Social Theory of the Nation-state: The Political Forms of Modernity beyond Methodological Nationalism* (Routledge, 2007) pp.145-46.

¹⁵ Actually, his view is not related to misanthropic approaches which undervalue the significance of the individual; his systems theory uses communication, rather than human beings, as the building block of society because he takes the individual seriously. See Niklas Luhmann, 'Operational Closure and Structural Coupling: The Differentiation of the Legal System' (1992) 13(5) *Cardozo Law Review*. p.1422. Luhmann argues that an individual thought or body should not be seen just as one part of society under the name of a human being that could be construed arbitrarily. In this context, the systems theorist criticises humanistic views because so-called human-centred approaches ironically attempt to restrict thought and bodies to a universal unity of human beings or human rationality. The fundamental problem with the humanistic view is that no concrete or universal consensus exists on human rationality or on how to organise society. These theoretical difficulties expose an individual to quite arbitrary interpretations which sometimes ironically generate authoritarian influences that organise and suppress the psychical, and even biological, operations of individuals under a certain kind of human-based rational rule. Consequently, the humanistic theory of society, which liberated the individual from religious metaphysics, was recaptured by another kind of metaphysics which controls the individual under the rule of social rationality. In this context, it is reasonable to assume that Luhmann intends to criticise the pressure for unilateral unity between society and the individual by keeping the individual at a relative distance from society. See Teubner (1993) (n 7) pp.44-46. See also Michael King and Chris Thornhill, *Niklas Luhmann's Theory of Politics and Law* (Palgrave Macmillan, 2003) pp.129-36; Chris Thornhill,

Taking into account the importance of communications in society, it is necessary to articulate the concept of communication; systems theory understands communication as comprising the steps of selection, such as information (*Information*), utterance (*Mitteilung*) and understanding (*Verstehen*).¹⁶ The social system has to make a series of selections about which meaning, of all the possible meanings, will enter into communication according to its own internal logic. Briefly, '[c]ommunication is the processing of the selection'.¹⁷ Firstly, information is a selection from many possibilities from among the thoughts of the psychic system.¹⁸ Through this process, some meanings could enter the communication process as communicable meanings while others remain meaningless in the environment (a psychic system). In this sense, one particular kind of utterance has to be selected from various possibilities because not all information is uttered in the same way.¹⁹ Finally, communication occurs only when the uttered information can be understood in a certain way. In fact, understanding is not related to the ability to recognise what is true, nor to the appropriate receipt of information. As with any other steps of the communication process, understanding is also a selection process because it requires selection from various possibilities whereby the same meaning can be understood in many different ways.²⁰ Furthermore, whether understanding is successful or not depends on whether it is responded to by a subsequent communication.²¹ According to Luhmann, '[u]nderstanding is never the mere duplication of the utterance in another consciousness but a condition of connection with further communication in the communication system'.²² In this regard, even misunderstanding – namely, when one gets something wrong – could be a form of understanding in the sense that it provokes another communication which thematises that misunderstanding.²³

Luhmann defines society as an exceptional type of social system, which 'includes all communications, reproduces all communications and constitutes meaningful horizons for further

'Niklas Luhmann's Political Theory: Politics after Metaphysics?' in Michael King and Chris Thornhill (eds), *Luhmann on Law and Politics: Critical Appraisals and Applications* (Hart, 2006) pp.80-81; Chris Thornhill, *German Political Philosophy: The Metaphysics of Law* (Routledge, 2007) pp.328-31 (regarding Luhmann's criticisms of the existing humanistic view).

¹⁶ Niklas Luhmann, 'What is Communication?' (1992) 2(3) *Communication Theory* p.252. See generally Claudio Baraldi, Giancarlo Corsi and Elena Esposito, *GLU: Glossar zu Niklas Luhmanns Theorie sozialer Systeme* (Suhrkamp, 1997) pp.89-93; Kneer and Nassehi (n 7) pp.81-95.

¹⁷ Niklas Luhmann, *Social Systems* (Stanford University Press, 1995) p.140.

¹⁸ Kneer and Nassehi (n 7) p.83.

¹⁹ *ibid.*

²⁰ *ibid.* p.85.

²¹ *ibid.* pp.84-85.

²² Luhmann (n 16) p.253.

²³ *ibid.*

communications'.²⁴ In other words, society as a social system exists only on the condition that previous communications can be connected to subsequent communications.²⁵ This idea is not foreign to other theoretical traditions, such as philosophical phenomenology or hermeneutics, which recognise that the current understanding of something is heavily influenced by previous understanding, which is engendered by the intentionality of consciousness (*Intentionalität des Bewußtseins*).²⁶ In addition, hermeneutics focuses on the point that a particular understanding of one part occurs through a tacit understanding of the other parts, or the whole – namely, that one can elicit a new meaning through pre-understanding (*Vorverständnis*) or prejudice. This inherent circularity of the understanding process, the hermeneutic circle, is similar to those self-referential structures whereby one meaning of a system refers to another meaning of the system itself. To sum up, '[w]e cannot communicate with each other except by drawing from the existing forms of communication, although we may use communications in novel ways'.²⁷

iii) Double contingency as an auto-catalyser for the formation of a social system

Although securing the connectivity of communications is necessary for the existence of a society, communications in a society suffer from incredible difficulties of double contingency which cripple the continuous production and reproduction of communications. The philosophical meaning of contingency is the state in which one thing is randomly selected among various alternatives without any logical necessity.²⁸ In other words, contingency implies the possibility that one thing could be referred to in other ways the next time – just as when one throws a dice. Therefore, contingency is always accompanied by a risk of disappointment, in which systemic selection happens differently from what is expected from an external perspective.²⁹ Double contingency emerges when the problem of contingency occurs at the social level, where sections of

²⁴ Niklas Luhmann, 'The World Society as a Social System' (1982) 8(3) *International Journal of General Systems* p.131.

²⁵ *ibid*; Kneer and Nassehi (n 7) p.65.

²⁶ Hans-Georg Moeller, *Luhmann Explained: From Souls to Systems* (Open Court, 2006) pp.181-85 (explaining the influence of phenomenology on Luhmann's systems theory). Husserl's influence on Luhmann cannot be ignored, although Luhmann understands that the production and operation of meanings are limited only to the individualised psychological perspective. See Gunther Teubner, 'A Constitutional Moment? The Logics of "Hit the Bottom"' in Poul F. Kjaer, Gunther Teubner and Alberto Febbrajo (eds), *The Financial Crisis in Constitutional Perspective: The Dark Side of Functional Differentiation* (Hart, 2011).

²⁷ Gunther Teubner, 'The Autonomy of Law: An Introduction to Legal Autopoiesis' in Anne Barron and others (eds), *Introduction to Jurisprudence and Legal Theory: Commentary and Materials* (Butterworths, 2002) p.900.

²⁸ Luhmann (n 17) p.106.

²⁹ Baraldi, Corsi and Esposito (n 16) pp.37-38.

two meaning-constituting systems depend on each other.³⁰ In other words, double contingency refers to a situation in which every selection of the ego as a meaning-constituting system depends not only on the ego itself, but also on the alter ego as another meaning-constituting system.³¹ This double contingency is based on two theoretical assumptions. Firstly, no one can take an action without considering how the other is supposed to act. In this sense, systems theory explicates the fact that the selectivity of one system depends on the selectivity of the other system.³² Secondly, two mutually dependent parties do not know each other's selection in advance because they operate indifferently. In fact, two social systems operate by selecting a particular meaning from among numerous possible meanings in its environment according to their own different logic, in a self-referential way. In this situation, one actor in the external environment is not informed of which meaning will be selected by the other actor because the selection standards of one system may be blind to the actors of the other system. In this sense, systems theory argues that one system looks like a black box to the other one.³³ Each system considers the other as its environment and it can observe only the external input-output process between the system and the environment without any knowledge of the internal self-referential process of selection.³⁴ For example, driver *A*'s action at an intersection depends on the selection of driver *B*, who is coming from a different direction; driver *A* can cross the road only when driver *A* can expect that driver *B* will stop his or her car for driver *A*. However, the two drivers cannot anticipate each other's exact reaction without any prior guidance because the two parties cannot swap their own brains with one another. Indeed, system *A* can guess system *B*'s selection only on the basis of system *A*'s internal logic – that is, system *A* cannot exactly guess system *B*'s *real* selection, but rather the not-yet-unfolding selection that is constructed by system *A*.³⁵ In this setting of mutual dependence and indifference, double contingency emerges as a repeated circularity that cripples the respective parties' communicative actions. The two systems cannot progress in communication because they constantly have to refer to each other: 'I will do what you want when you do what I want'.³⁶

Nevertheless, this double contingency serves as an auto-catalyst for the formation of social systems. According to systems theory, the dilemma of double contingency is ultimately managed because this double contingency puts pressure on society by interrupting the connection of

³⁰ *ibid.*

³¹ *ibid.* p.38.

³² *ibid.* pp.37-38.

³³ *ibid.* p.38. See also Luhmann (n 17) pp.109-10.

³⁴ Baraldi, Corsi and Esposito (n 16) p.38.

³⁵ *ibid.* p.39.

³⁶ *ibid.* pp.38-39.

communications. Of course, the society has no necessary obligation to solve these double contingency problems. However, as long as society wants to exist in the form of a continuum of communications, it needs to deal with this pressure; if it cannot or will not solve this problem, it disappears. As a result, double contingency always provokes a specific problem-solving process, which leads to the emergence of the social system as it continuously encounters problems and propels actors to resolve those problems.³⁷ Finally, the social system is formed in the course of structuralising the possibility of communication in the condition of uncertainty brought about by double contingency.³⁸

iv) The role of expectation in dealing with double contingency

Expectation plays an important role in dealing with the double contingency problem at the level of the social system. In systems theory, an expectation is not a reference to the conventional notion of ‘an actual state of consciousness of a given individual human being’.³⁹ Luhmann explains that ‘expectations indicate what a given meaning situation foresees’.⁴⁰ In other words, an expectation is a typical situation that an actor conventionally anticipates before taking an action. Expectations are socially generated through historical patterning of repeated social behaviours. The expectation is condensed and confirmed very gradually as social actors deal with similar situations over a long time.

It is undeniable that the mere formation of an expectation does not eliminate all risk of double contingency, but merely transforms it into a problem of the expectation of expectation – namely, the production of expectation and the management of disappointment. For instance, expectation alone does not allow driver *A* to expect driver *B*’s reaction because driver *A*’s expectation of that reaction is what is reconstructed by driver *A*, who hypothetically puts him- or herself in driver *B*’s situation. In other words, actor *A* has to expect what actor *B* expects of what actor *A* expects of what actor *B* expects and so on and so on, so that social communication is trapped in a circularity of double, triple and ultimately infinite expectations.

Nonetheless, expectations can enhance the possibility of successful communication because they have a function that allows society to effectively manage the incredible complexity of double contingency. As such, socially generalised expectations reduce ranges of possibility to a manageable scale as they can inform the actors in a given situation of the scope of the possible

³⁷ *ibid* p.39.

³⁸ *ibid*.

³⁹ Niklas Luhmann, *Law as a Social System* (Oxford University Press, 2004) p.143.

⁴⁰ Luhmann (n 17) p.96.

selections of the other party. Returning to the theoretical model of the intersection, driver *A*, relying on generalised expectations, can expect a limited number of situations – namely, that driver *B* will pass or will stop. At the same time, the driver can exclude the possibility of certain extraordinary scenarios; for example, driver *B*'s car will suddenly disappear for no foreseeable reason, like an earthquake. To put it simply, expectation makes unexpectability and variability expectable.⁴¹

In addition to expectations of expectations, society is required to deal with the risk of the disappointment of expectations. The statement that expectation does not eradicate double contingency but increases the chances of successful communication means that expectations of expectations always accompany the disappointment of expectations. Expectability cannot guarantee the realisation of the expected situation. For instance, driver *A* cannot clearly predict what action driver *B* will take among the expectable action choices (i.e., going or stopping). In this situation, driver *A* still suffers from the risk that his or her expectation will be betrayed by the other party's action. Likewise, society is under more pressure to react to the risk of disappointment which invokes a new problem-solving process.⁴²

C. Globalisation as functional differentiation

Systems theorists explain that globalisation is a result of functional differentiation, where society differentiates itself into many sub-societies to process double contingency in accordance with their own intrinsic functions. Strictly speaking, globalisation is nothing more than the radical emergence of various sub-social systems.⁴³ Society is required to facilitate the specific structures that produce expectations on the one hand, and manage its accompanying risks of disappointment, on the other. However, modern society is too complex to propose a general structure that is appropriate for all communicative situations. Therefore, society as a whole is differentiated into several sub-societies which deal with the expectation of expectation in a particular type of communication. All functions within society are allocated exclusively to its sub-societies (e.g., economic, legal and political systems) according to the specific roles that those sub-societies take up in favour of the continuity of communications.⁴⁴ As a result, society is differentiated into multi-polar sub-societies which operate according to their own rationalities or functional purposes.⁴⁵

⁴¹ Baraldi, Corsi and Esposito (n 16) pp.46-47.

⁴² *ibid* p.48.

⁴³ Niklas Luhmann, *A Sociological Theory of Law* (Routledge & Kegan Paul, 1985) p.257.

⁴⁴ The concept of a function gains a different meaning from its mundane meaning. To put it more concretely, concepts such as functionality or function should not be construed as only reaching a certain solution; rather, such concepts indicate continuous connections between the problem and the solution. The system is functional

In systems theory, the specified structure of a social system can be made operational by applying a code, namely, a specific form which can be used to connect one communication to another.⁴⁶ As long as the communication is a selection, the original form of this operation is basically binary – namely, whether to select or not. In this context, each system understands external events by applying the binary value. Although the codes in all sub-societies are binary from a formative perspective, the contents of these codes are verified from the substantive perspective of social functions. For example, political systems use concepts of governing/opposition as code in an attempt to provide collectively binding decisions for society; by the same token, the economic system employs possession/non-possession as its own code in the course of material reproduction. Despite such variety in the contents of their codes, every system shares the same basic form which is divided into a positive and negative value.⁴⁷ Luhmann explains that, like two people speaking different languages, every system only understands and uses its own code and cannot communicate with the code of another system.⁴⁸ Therefore, sub-societies understand the same meaning according to their own disparate rationalities of communication. For example, issues regarding off-shore oil drilling might be communicated differently in the economic system and the political system; the economic system may place the profitability of oil drilling at its analytical centre, whereas the communication of the political system operates according to the effects of oil-drilling policies on the next election.

Systems theory understands globalisation as an ineluctable consequence and the global expansion of modern functional differentiation.⁴⁹ The emergence of modern society means a transition from a stratified to a functionally differentiated society.⁵⁰ The political system, together with religious and economic systems, has differentiated itself into an autonomous system as the stratified world has degenerated.⁵¹ The political system justifies its control over other sub-societies, such as the economic system, according to territorial sovereignty under the symbolic unity of the

when problems of double contingency are raised and solved under a particular structure of expectations so as to allow further communications to continue. See Michael King and Schutz Anton, 'The Ambitious Modesty of Niklas Luhmann' (1994) 21(3) *Journal of Law and Society* pp.265-66; Luhmann (n 17) p.52ff. See also King and Thornhill (n 15) pp.9-11.

⁴⁵ Luhmann (n 24) pp.131-32.

⁴⁶ See generally Baraldi, Corsi and Esposito (n 16) pp.33-37.

⁴⁷ Niklas Luhmann, 'The Coding of the Legal System' in Gunther Teubner and Alberto Febbrajo (eds), *State, Law and Economy as Autopoietic Systems: Regulation and Autonomy in a New Perspective* (Guiffre, 1992) p.152.

⁴⁸ Kneer and Nassehi (n 7) pp.122-41 (for a more detailed discussion).

⁴⁹ Luhmann (n 43) pp.256-257. See also Niklas Luhmann, 'Globalization or World Society?: How to Conceive of Modern Society' (1997) 7(1) *International Review of Sociology*.

⁵⁰ Luhmann (n 24) pp.131-32.

⁵¹ *ibid* p.132.

nation-state. However, as functional differentiation has become more radical, other individual sub-societies have evolved autopoietically beyond the territorial boundaries of the political system. To the extent that many non-political sub-societies have gained their autonomy through autopoiesis, the territory-based political system has lost its ascendancy, so that the nation-state is now just one of many sub-societies.⁵² At the same time, sub-societies that have been liberated from the state operate to produce their own communicative networks according to their own sub-systemic rationalities beyond national territory. The communications of sub-societies spread globally because their code applies universally; the core logic of economic communications operates everywhere in the same way regardless of national origin.⁵³ This trend of functional differentiation fragments the world into multi-polar networks of social communication based on the use of discursive differences. Indeed, globalisation has changed the primary cognitive units with which to observe (divide) the world from territoriality to discursivity.⁵⁴ In the globalised world, the contours of one sub-society are drawn mainly by the discursive differences arising from adjacent sub-societies.⁵⁵

D. Formation of the global regime as a global bargain

The global regime is formed as a non-physical communicative sphere in which functionally differentiated sub-societies compete or cooperate in dealing with a common issue. Such cooperation or competition (even conflicts) among sub-societies can be recognised as a result of interplays between actors which are influenced by each sub-society; for example, a global company is an actor in the economic system which operates according to economic rationality, whereas the state is an agent of the political system. Conflict or cooperation between economic and political systems is observable only in the form of conflict or cooperation between the global company and the nation-state.⁵⁶ Based on this theoretical assumption, systems theorists define a global regime as

⁵² Niklas Luhmann, *Political Theory in the Welfare State* (W. de Gruyter, 1990) p.30. See also Chernilo (n 14) p.148.

⁵³ Moeller (n 26) pp.52-63.

⁵⁴ Luhmann (n 24) p.132.

⁵⁵ Gunther Teubner and Andreas Fischer-Lescano, 'Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law' (2004) 25(4) *Michigan Journal of International Law* pp.1004-05. See also Gunther Teubner, 'De collisione discursuum: Communicative Rationalities in Law, Morality and Politics' (1996) 17(4-5) *Cardozo Law Review*; Gunther Teubner, 'A Collision of Discourses: Foreword' in Richard Nobles and David Schiff (eds), *Understanding Miscarriages of Justice: Law, the Media, and the Inevitability of Crisis* (Oxford University Press, 2000).

⁵⁶ While society does not consist of actors or actions, an external observer can describe the operations of communication of a social system in the form of actors' behaviours. See Kneer and Nassehi (n 7) pp.81-95. Here, the concept of an actor is similar to that of a person, or 'a system- and situation- specified receiver of social communication' See *ibid* p.165. See also Zenon Bankowski, 'How Does It Feel to Be on Your Own?

an issue-driven hetero-anarchical sphere which is fragmented by its own discursive boundaries;⁵⁷ it also emerges as ‘a temporary or, in some cases, lasting cluster or network of functionally specialized communication’⁵⁸ by serving as a circumstance which can produce law beyond nation-states.⁵⁹

i) Features of the global regime

The features of the global regime can be analysed from two aspects. Firstly, the regime of systems theory is an ‘issue-driven’ network in that a specific common issue is an important motivation for the regime.⁶⁰ In a similar context, international regime theorists propose the concept of a ‘principle’ to explain the elements that encourage regime members to take part in the regime.⁶¹ This principle is a belief ‘that cooperation in a particular area will lead to some desired outcome’.⁶² For example, the international regime for the prevention of nuclear proliferation is based on the belief that the regime will control the likelihood of a nuclear war occurring. This concept of a principle can be matched with a common global issue which drives global actors to compete and cooperate.

The Person in the Sight of Autopoiesis’ (1994) 7(2) Ratio Juris. The concept of a person does not refer to a human being, but to any other entity, as seen in the discussion of a corporation as a legal person. Gunther Teubner, ‘Enterprise Corporatism: New Industrial Policy and the “Essence” of the Legal Person’ (1988) 36(1) The American Journal of Comparative Law; Gunther Teubner, ‘Rights of Non-humans? Electronic Agents and Animals as New Actors in Politics and Law’ (2006) 33(4) Journal of Law and Society. For example, the political system can observe economic communication in the form of corporate behaviour. In turn, the economic system can understand the operation of political systems in terms of legislation or administration of government. Seen from this point of view, the psychological problems of actors such as ‘phenomena of collective addiction’ cannot be entirely ascribed to the crisis of the global economy because actors are propelled by communications belonging to the self-expansive economic system. In particular, solutions should be found in incongruous structural frictions between the economy and other systemic conflicts rather than in reprimands for individual wrongdoing. See Teubner (n 26).

⁵⁷ Gunther Teubner, ‘Fragmented Foundations: Societal Constitutionalism beyond the Nation State’ in Petra Dobner and Martin Loughlin (eds), *The Twilight of Constitutionalism?* (Oxford University Press, 2010) pp.329-34.

⁵⁸ Galf-Peter Calliess and Peer Zumbansen, *Rough Consensus and Running Code: A Theory of Transnational Private Law* (Hart, 2010) p.46.

⁵⁹ See generally Gunther Teubner, ‘Global Private Regimes: Neo-Spontaneous Law and Dual Constitution of Autonomous Sectors?’ in Karl-Heinz Ladeur (ed) *Public Governance in the Age of Globalization* (Ashgate, 2004) pp.72-75; Teubner and Fischer-Lescano (n 55) pp.1009-12; Dirk Baecker, ‘The Power to Rule the World’ in Galf-Peter Calliess and others (eds), *Soziologische Jurisprudenz Festschrift für Gunther Teubner zum 65. Geburtstag* (De Gruyter Recht, 2009) pp.673-74; Teubner (n 57) pp.331-32. See also Gunther Teubner, ‘The Private/public Dichotomy: After the Critique?’ (2007) <<http://www.re-public.gr/en/?p=99>> accessed 15 April 2012; Gunther Teubner, ‘State Policies in Private Law? Comment on Hanoch Dogan’ (2008) 56(3) The American Journal of Comparative Law; Calliess and Zumbansen (n 58) p.96ff. (discussing challenges to the traditional public/private distinction, ranging from the domestic to the global level).

⁶⁰ Calliess and Zumbansen (n 58) p.46.

⁶¹ Krasner (1983) (n 4) p.2.

⁶² Jeswald W. Salacuse, ‘The Emerging Global Regime for Investment’ (2010) 51(2) Harvard International Law Journal p.448.

Secondly, the global regime is characterised by globality because the regime boundary is formed not on a statist basis, but on the basis of an ‘invisible’ communicative network of state and non-state actors.⁶³ In the functionally differentiated society, nation-states have ceased to be a symbolic unity which represents sub-societies and controls functional differentiation within its territorial boundaries.⁶⁴ Instead, nation-states remain ‘merely a self-description of politics’ by ‘personalizing parts of the political process in the image of a collective actor’.⁶⁵ Therefore, recognition of the global regime can reflect the current hybrid phenomenon of the blurring of hierarchical and formal divisions between state and non-state actors, or public and private subjects.⁶⁶ Instead, those global actors or actions are connected by acquiring access to a communicative network that the traditional state-centred approach could not clearly recognize.⁶⁷

ii) The logic of global regime formation

The rationale propelling regime members to form a global regime is not just some naive moral sense for humanism or altruism, but a strategic rational calculation to circumvent the worst-case scenario of functional differentiation. This explanation, by and large, fits with the logic of domestic social contract theory and international regime theory; whereas international society is

⁶³ Gunther Teubner and Peter Korth, ‘Two Kinds of Legal Pluralism: Collision of Laws in the Double Fragmentation of World Society’ (2009) p.6 <<http://ssrn.com/paper=1416041>> accessed 15 April 2012.

⁶⁴ Luhmann (n 24) p.132; Luhmann (1997) (n 49) p.72.

⁶⁵ Gunther Teubner, ‘The “State” of Private Networks: The Emerging Legal Regime’ (1993) 1993(2) Brigham Young University Law Review pp.556-57. See also Luhmann (1990) (n 52) p.123; Luhmann (1990) (n 11) p.169; Chernilo (n 14) p.150.

⁶⁶ A. Claire Cutler, ‘Artifice, Ideology and Paradox: The Public/private Distinction in International Law’ (1997) 4(2) Review of International Political Economy; A. Claire Cutler, ‘Critical Reflections on the Westphalian Assumptions of International Law and Organization: A Crisis of Legitimacy’ (2001) 27(2) Review of International Studies (regarding the so-called subject question in international law).

⁶⁷ However, such globality does not downplay the importance of the nation-state in the global regime because functional differentiation does not intend to nullify a particular sub-society but just to create certain conditions for the coexistence of many sub-societies. In other words, although the absolute power of the territorialised political system is expected to be, to some extent, checked under the driving force of functional differentiation, it retains an important functional role in providing collectively binding decisions over society. In fact, many global regimes could not have been established without support from nation-states as agents of the political system; otherwise, the establishment of global regimes requires at least tacit or official self-restraint by sovereign powers. Nevertheless, this does not allow for the monopoly status of one particular system which disturbs the coexistence of equally differentiated sub-societies because functional differentiation prevents one sub-society from dominating all communicative contexts in the global regime. Thus, regardless of how influential nation-states and their politics are, they cannot completely invalidate other neighbouring sub-systems. To summarise, the nation-state as one of the most influential global actors can take part in global communicative systems. In a similar vein, Sassen considers current nation-states to be global actors who can participate in a globalised social mechanism. See Saskia Sassen, *Losing Control?: Sovereignty in an Age of Globalization* (Columbia University Press, 1996); Saskia Sassen, ‘Globalization or Denationalization?’ (2001) 10(1) Review of International Political Economy pp.4-5; Saskia Sassen, ‘The State and Globalization’ (2003) 5(2) Interventions: International Journal of Postcolonial Studies; Saskia Sassen, ‘The Participation of States and Citizens in Global Governance’ (2003) 10(1) Indiana Journal of Global Legal Studies; Saskia Sassen, *Territory, Authority, Rights: From Medieval to Global Assemblages* (Princeton University Press, 2008).

presumed to consist of individual sovereign states, the global regime is formed by global actors who represent sub-societies. Therefore, global regime theory shows a similar but slightly different picture due to the autopoiesis of functionally differentiated sub-societies.

Global actors are mutually dependent and so cannot be effectually operational without acquiring voluntary cooperation from the others. Unlike the pure domestic social contract theory, systems theory cannot logically presume the state of nature because individual autopoietic sub-societies cannot exist as freestanding systems. Looking back at the concept of autopoiesis, one system considers other systems to be its environment, and produces meaning by observing and applying its own binary code to the operations of the other systems. In other words, the identity of one system is delineated by its environment – namely, other systems. An example from human cognitive development is a baby gaining self-consciousness only by observing others and establishing him- or herself against others. Likewise, an economic system can initiate communication only by observing the operations of the political system, such as regulation or deregulation. In addition, economic actors can make contracts under the legal system's contract law.

Despite their mutual dependency, social systems and their actors compete with one another because the systems understand the same issues according to their own rationalities of sub-societies. Rationality is functionally differentiated into so many disparate rationalities that no universal rationality exists. This situation leads to a number of rationality conflicts which are recognised as social conflicts among global actors. The previous world recognised conflicts at the places where different nation-states collided, whereas new global conflicts now happen when the rationalities of different systems meet.⁶⁸ To take the example of copies of patent-protected medicines, it might not be plausible to solve this conflict in the context of collisions between nation-states. Globalisation construes the conflict as existing between economic and public health systems: the transnational company's patent rights, in the economic sense, versus the human rights protection recognised in the public health system.⁶⁹ In addition to mutual indifference, the blind expansion of systemic rationality exacerbates the risk of generating a dog-eat-dog world in which one system dominates all the other systems under a particular systemic rationality.⁷⁰ Ironically, the unilateral expansion of one system is self-destructive, culminating in the total debacle of the world as a whole. To be more

⁶⁸ Gunther Teubner, 'Altera pars audiatur: Law in the Collision of Discourses' in Richard Rawlings (ed) *Law, Society, and Economy: Centenary Essays for the London School of Economics and Political Science, 1895-1995* (Oxford University Press, 1997) p.159.

⁶⁹ Teubner and Fischer-Lescano (n 55) pp.1024-34.

⁷⁰ This is similar to what Habermas describes as colonisation of the life-world (*Lebenswelt*). See Jürgen Habermas, *The Theory of Communicative Action*(Vol. 2): *Lifeworld and System: A Critique of Functionalist Reason* (Polity Press, 1987), p.113ff.

exact, the autocratic expansion of system *A* reels back against system *A* itself because it encroaches upon system *B* – namely, the environment of system *A*. Moreover, such a collapse of one system increases the risk of a chain reaction, leading to another system's collapse.⁷¹

Finally, a global regime cannot emerge until global actors are motivated by a globally shared sense of urgency surrounding a global issue. Understanding globalisation as functional differentiation makes it clear that systems are existentially dependent on, but operationally indifferent to, one another; each system dances until the music stops. In this context, globalisation is the culprit which creates more possible conflicts to the exact extent that it can promote a greater chance of communication. Of course, today people rarely experience worldwide international conflicts, such as World Wars I and II. However, it is worth noting that the current globalised world suffers a similar degree of conflict in the sense that numerous small but severe social skirmishes occur in the form of rationality conflicts between discursive sectors in everyday life and everywhere else beyond national borders. If these conflicts are not kept within manageable levels, globalisation as functional differentiation might freeze mutual communications among global actors. Their shared fears of a possible worst-case scenario lead each member to compromise in order to secure long-term benefits and concede short-term losses through the establishment of a regime. More specifically, competing actors of sub-societies delegate their own powers to global administrative entities which are supposed to secure each actor's minimum substantive interests. Of course, this compromise is not a one-shot game in which every actor can reach a particular equilibrium simultaneously based on accurate calculations out of the blue. In reality, the trajectory of regime formation is tortuous as regime members can temporarily agree on a particular cursory structure at one time, but renegotiate it at other times. The equilibrium of power relations among global actors is achieved and changed through trial and error in the course of the interminable circularity between conflicts and their resolution; although one system attempts to dominate the regime temporarily, it encounters conflicts and is ultimately forced to give in to other systems.

E. Formation of the global investment regime

The idea of global regime theory is applicable to the global investment field; the GIR is formed by global state/non-state actors who are required to deal with common global investment issues, namely the protection and restriction of global investment. Initially, some investment

⁷¹ Luhmann (n 43) p. 257. See also Rudolf Stichweh, 'Toward a General Theory of Function System Crises' in Poul F. Kjaer, Gunther Teubner and Alberto Febbrajo (eds), *The Financial Crisis in Constitutional Perspective: The Dark Side of Functional Differentiation* (Hart, 2011) (explaining how the expansive rationality of the economy causes a self-destructive impact on the economy itself and on other social systems).

lawyers have attempted to apply traditional regime theory to GIL in order to explicate why more than 2,500 international investment treaties and their arbitrations share very similar legal terms and rules, even though all of these treaties were individually established.⁷² The systems theoretic application of regime theory takes a further step by assuming that the GIR comprises not only state actors but also non-state actors which operate under other sub-societies.

i) Principle of the global investment regime: a balance between protection and restriction of global investment

The fundamental engine causing actors to form the GIR is a global consensus concerning the need for mechanisms for the protection and restriction of global investment. This global consensus is initiated by fear of the destructive thrusts of functional differentiation. This risk basically originates from the double contingency situation where one system cannot predict the other system's operation in advance. In a functionally differentiated society, each actor competes in order to deal with the global investment issues in favour of its own rationality, on the one hand, and is mutually dependent with other actors, on the other. Here, if actors pursue their own interests by ignoring other actors and rationalities, such unilateral expansive thrusts run the risk of occasioning the total collapse of the global investment field; for example, if the nation-state were to undertake politically driven intervention in an extreme fashion, it could block all economic activities. At the same time, the abuse of rapacious global investment colonises the autonomy of civil societies.

In this context, the principle of the GIR does not reflect only the predilection for investment protection but a balance between the protection and restriction of investment. As increasingly varied actors engaged in the formation of the GIR, global investment issues become engaged in more varied contexts, ranging from economic concerns to environmental or human rights issues. In a functionally differentiated world, each agent (actor) of each sub-system interprets this principle in its own way. In other words, the opinions of global actors in the GIR could principally be categorised according to their attitudes towards the protection and restriction of global investment. In this context, it sounds more reasonable to say that the principle of the GIR pursues the appropriate protection and restriction of global investment.

To conclude, the principle of balance between investment protection and restriction in the global regime serves as a motivation to attract global actors, who want to avoid the risk of regime collapse. In this context, the GIR is an issue-driven global network in the sense that the pursuit of

⁷² Salacuse (n 62); Jeswald W. Salacuse, *The Law of Investment Treaties* (Oxford University Press, 2010) pp.1-17.

the appropriate protection and restriction of global investment could serve as a principle to make relevant state and non-state actors comply with the regime. Simultaneously, it is worth noting that this principle serves as a source of conflict because all global actors interpret the same principle for their own sakes. For example, economic actors want to give more weight to legitimate investment protection, whereas nation-states hope to accentuate the legitimate regulatory power of the host state.

ii) Strategic calculation for a certain bargain among regime members

As a result, the creation of the GIR is the result of strategic rational calculation among all actors who trade off their short term interests for longer term benefits in the course of dealing with a regime principle; namely, the protection and restriction of global investment. This rational calculation is empirically and gradually achieved through the interminable trial and error of global actors who expand their own rationality against or make concession to other actors.

First of all, global investors are better off where a GIR is established. In fact, the economic activities of private actors would not work efficiently without formal and practical support from nation-states. The cooperation of the host state is necessary in making investments because many investments are closely related to the state's long-term projects or to public interest at the domestic level. Further, in an extreme case where the host state withdraws protection of an investment-related project arbitrarily, private actors have no other formal power to control the state. To be specific, foreign investors suffer from an insuperable 'dynamic inconsistency problem', in which the host state has unilateral discretion to withdraw its commitment to a contract with a foreign investor at any time once the investment is placed.⁷³ Therefore, it is crucial for the investor to persuade the host state to voluntarily protect the investment. Of course, the investment restriction provisions prescribed directly or indirectly in the investment treaties may carry the risk of crippling the economic activities of investors. However, this risk can be counterbalanced by the host state's own commitment to investment protection, insofar as the restriction is reasonably tolerable.

Nation-states in the GIR have three key tasks: i) they must protect their own citizens' investments abroad; ii) they need to attract foreign investment; and iii) they need to control foreign investment at home. Those tasks are required because nation-states operate only around a particular

⁷³ Andrew T. Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38(4) *Virginia Journal of International Law* pp.658-66; Andrew T. Guzman, 'Explaining the Popularity of Bilateral Investment Treaties' in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment* (Oxford University Press, 2009) pp.78-83.

political rationality; for example, whether the nation-state can secure political legitimacy to govern the people.

Nation-states hope to sign investment treaties in order to protect the property of their own citizens located abroad without any direct diplomatic friction with the host state.⁷⁴ In fact, states currently find it increasingly difficult to unilaterally protect their own citizens' property when it is located in another state. For example, gunboat policies and retaliation commonly lead to political or diplomatic crises with host states. At the same time, investment-exporting states might face political criticism if they turned a blind eye to the sufferings of their own citizens. The global regime could save the home state from such dilemmatic burdens by facilitating its citizens to demand remedies on their own account.⁷⁵

Here, it looks paradoxical for nation-states, particularly developing countries, to sign an investment treaty to deal with foreign investment. Guzman, applying the prisoner's dilemma, argues that individual nation-states bid down their regulatory power for investors through the separate conclusion of investment treaties in the course of competing to attract more investors; although they could have maximised their best interests through collective cooperation in establishing a Charter of Economic Rights and Duties of States.⁷⁶ Eventually, the competitive conclusion of BITs may ultimately cause more harm to the developing countries.

However, whether a race-to-the-bottom situation of the kind that Guzmán anticipates⁷⁷ will really happen in the GIR if one considers the nation-state to be a political entity, is questionable. Firstly, it is worth noting that nation-states do not operate in exactly the same way as private firms in the market.⁷⁸ Political rationality fundamentally influences the individual and collective behaviour of nation-states; more precisely, nation-states treat global investment differently according to the expected political benefits. Nation-states operating according to political rationality protect global investment on the condition that the foreign investment is expected to boost the national economy, which is associated with the achievement or maintenance of public support. To put it conversely, nation-states might simply withdraw any commitment to investment protection if

⁷⁴ Kenneth J. Vandevelde, 'A Brief History of International Investment Agreements' in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment* (Oxford University Press, 2009) pp.12-15.

⁷⁵ Salacuse (n 62) pp.462-63.

⁷⁶ Guzman (1998) (n 73) pp.669-74; Guzman (2009) (n 73) pp.85-88.

⁷⁷ Guzman (1998) (n 73) pp.671-72.

⁷⁸ Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Hart Publishing, 2009) p.90

the sovereignty costs of the political system were to overwhelm the benefits of investment protection in an extreme case; for example, if the changed regulation for investment protection were to cause insuperable public resistance.

Given such assumptions, participation in the GIR could be considered to be a sub-optimal choice because the GIR can help the nation-state to secure minimum control of global investment without any serious damage to its reputation among global investors. Of course, it is hard to deny Guzman's assumption that host states are individually under pressure from competitive forces where even a small regulatory change is too sensitive to the inflow of global investment.⁷⁹ However, the individual choice of the nation-state as an agent of the political system is influenced not only by the sensitivity of investors to policy changes but also by the resistance of various social movements which represent other social rationalities. For instance, domestic governments are supposed to screen the inflow of foreign investment more strictly if the abuse of investor rights causes environmental concerns, thus negatively affecting potential victory in the next election.

Here, the nation-state could persuade global investors by joining the crowd rather than by offering a risky deal. While the nation-state gives a positive signal to potential investors by signing BITs, it might be reluctant to promise more investment protection than a generally accepted standard. Of course, it is true that nation-states can attract more foreign investment by proposing more favourable terms in order to beat other competing states. However, switching to a new type of BIT could run the risk of future uncertain political risks or sovereignty costs⁸⁰ caused by the abuse of global investors. As a result, many nation-states negotiate BITs according to a set of standardised norms by updating model BITs or the previously successful BITs of economically strong countries, such as the U.S. Model BIT or NAFTA.⁸¹ If a new BIT follows the standardised model, the foreign investors whose home states are influencing the standardisation of the BIT feel more comfortable.

⁷⁹ Guzman (1998) (n 73) pp.669-71. In fact, there is no concrete empirical evidence as to whether and how the conclusion of a BIT has influenced foreign investors because an investment decision is influenced by many different factors, including cheap labour costs and political stability. See generally Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows* (Oxford University Press, 2009); Jason Webb Yackee, 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' (2011) 51(2) *Virginia Journal of International Law*. Nevertheless, it is not readily deniable that an investor would prefer making an investment in a BIT country than in a non-BIT country under the same conditions.

⁸⁰ Montt (n 78) pp.89-90.

⁸¹ Montt argues that the choice of individual nation-states regarding the convergence of many BITs can be fully explained within the framework of the network model in which a new actor prefers the existing technology that more actors have already chosen. See *ibid* pp.90-123. His argument provides meaningful insights for understanding the dynamics of GIR formation, especially in the context of this thesis. Nevertheless,

Most importantly, the nation-state can control global investment under global regime standards without suffering any serious reputational damage. The treaty-making practices of nation-states standardise not only the investors' rights but also the regulatory power of the host states. The protection level of the regulatory power might not be below the standards defined by the most developed countries because those developed countries are also interested in securing a minimum scope of regulatory power; as such the U.S. Trade Act of 2002 which prescribes that foreign investors cannot have more rights than U.S. investors in the U.S. and that U.S. BITs should be drafted according to U.S. legal doctrine and practices.⁸² Such standards would not cause serious reputational harm to the state parties because they look reasonable to potential investors whose home states are mainly strong countries influencing the standardisation of the BIT. As a result, the regulatory power of the host state is generalised and acceptable to the extent that investment protection is acceptable.

Of course, it seems undeniable that overall levels of investment protection and regulatory power incorporated into the BITs are dominated solely by the interests of the most developed countries, such the U.S. or the U.K., which are leading the standardisation.

However, even if this is to some extent true in current investment practices, global and national public opinions have emerged as strong candidates to control investor-oriented or developed-country oriented inclinations in BIT negotiations. For example, the U.S. BIT programme has changed in the wake of global and national criticisms of NAFTA experiences and the neo-liberal thrust. Also, less developed or developing countries could be checked by their respective national social movements which can push a negotiating government to level up investment restriction standards in the BIT. Consequently, the overall convergence point could be, to some extent, controlled by the ups and downs of the power of global and national social movements.

In this context, a social movement is another promising GIR player that can affect the behaviours of other actors – although Salacuse omits the future potential of these social movements in his explication of GIR formation. It is therefore hard to say that the interests of global investment

it is somewhat suspicious whether it can be directly applied to the GIR because individual nation-states are not equal rational choosers, in contrast to the basic theoretical assumption of network modelling. In terms of the bandwagon effect, an individual nation-state hops on to a bandwagon (a model BIT) due to the dominant political and economic position of the model, rather than due to its network benefits. In other words, an individual state follows a standardised model, not because many states follow this model BIT, but because the model is created by the powerful states from which many global investors hail. Although some network benefits are available, they are limited or softened by the extent of inequality between nation-states.

⁸² 19 U.S.C. §3802(b)(3).

issues are not associated with social values such as human rights, as global investment has become more closely related to the everyday lives of ordinary people.⁸³ The idea of a ‘spotlight phenomenon’⁸⁴ might be helpful in understanding how social movements can effectively control their global economic and political environments. The social movements and the mass media put pressure on global companies by revealing their wrongdoings. Public pressure arising from human rights issues directly or indirectly impairs a companies’ reputational value. This mechanism works more effectively in industries in which a company’s brand name or world reputation heavily affects sales. This dynamic allows global or national civil organisations to effectively monitor multinational corporate behaviour through strategies like naming and shaming.⁸⁵ Against this backdrop, global business and nation-states cannot achieve their own goals successfully without persuading global social movements in many areas. Nowadays, the impact of social movements, which represent non-economic and non-political sub-societies, has gradually become more palpable as global investment has become more closely related to the everyday lives of ordinary people.

Against this background, social movements can use their limited but unignorable influence creatively for their mutual benefit by relying on the global regime. Civil society and nation-states have discussed a number of norms to regulate the social responsibility of global investors.⁸⁶ Despite their increasing influence, social movements do not have enough power to directly control state actors or private economic actors in accordance with their own expectations. For example, they are not able to reach a general consensus as to how to enforce such normative systems.⁸⁷ In this context, it might be wise and cost-efficient for global civil society to make global investment responsible to the public interest through participation in the regime. Thus, instead of exercising a doubtful and demanding form of direct social control, social movements could optimise the possibility of controlling misbehaviour by global investors and guiding good business practices

⁸³ Fiona Harris, ‘Brands, Corporate Social Responsibility and Reputation’ in Aurora Voiculescu and Helen Yanacopoulos (eds), *The Business of Human rights: An Evolving Agenda for Corporate Responsibility* (Zed, 2011).

⁸⁴ Debora Spar, ‘The Spotlight and the Bottom Line-How Multinationals Export Human Rights’ (1998) 77(2) *Foreign Affairs*; Debora Spar, ‘Foreign Investment and Human Rights’ (1999) 42(1) *Challenge*.

⁸⁵ Ralph G. Steinhardt, ‘Corporate Responsibility and the International Law of Human Rights’ in Philip Alston (ed) *Non-state Actors and Human Rights* (Oxford University Press, 2005) pp.185-86.

⁸⁶ See generally Rhys Jenkins, ‘Corporate Codes of Conduct: Self-regulation in a Global Economy (UNRISD Programme Paper)’ (2001) <[http://www.unrisd.org/unrisd/website/document.nsf/0/e3b3e78bab9a886f80256b5e00344278/\\$FILE/jenkins.pdf](http://www.unrisd.org/unrisd/website/document.nsf/0/e3b3e78bab9a886f80256b5e00344278/$FILE/jenkins.pdf)> accessed 15 April 2012.

⁸⁷ David Kinley, Justine Nolan and Natalie Zerial, ‘The Politics of Corporate Social Responsibility: Reflections on the United Nations Human Rights Norms for Corporations’ (2007) 25(1) *Company and Securities Law Journal* pp.35-36; Scott Jerbi, ‘Business and Human Rights at the UN; What Might Happen Next?’ (2009) 31(2) *Human Rights Quarterly*.

through the self-compliance of global investors and nation-states. In the first instance, civic groups can push investment treaty drafters to take into account the public interest; then, they can expect that the self-enforcement mechanisms would control regime actors without too much resistance from nation-states and global investors. This strategy might also look acceptable to foreign investors as well as state actors, as long as they admit that they cannot function without civil society. Therefore, global investors might tolerate reasonable restrictions in order to prevent a worst case scenario, such as the paralysis of global business.

This strategy was discussed in the NAFTA and KORUS-FTA context. Chapter 19 of KORUS-FTA mainly originated from the North American Agreement on Labor Cooperation (NAALC), which was established as a side agreement to the NAFTA. This agreement was concluded due to strong demands from U.S. civil society and trade unions, who had criticised NAFTA's pro-business tendencies.⁸⁸ They attempted to incorporate labour standards into the treaty agreement in exchange for cooperation with the investment treaty. According to this agreement, individuals or NGOs are able to take part in dispute settlement and policy considerations regarding labour issues. It is true that Korean civil society has also taken a passive attitude toward KORUS-FTA Chapter 19 because the protection under Chapter 19 is insufficient to balance out the harm caused by investment protection as per the whole KORUS-FTA.⁸⁹ Nevertheless, some commentators expect civil society to be able to utilise such global standardization of labour protection as a tool to deal with the emerging power of private investors in the investment field through active participation in norm-making. In other words, labour protection can be effectively secured to the exact extent that investment protection is effective.⁹⁰

III. THE FUNCTIONAL NECESSITY OF LAW IN THE GLOBAL INVESTMENT REGIME

A. Achilles' heel of the global investment regime

As described in the previous part, the GIR is established on a finely tuned equilibrium of power relations among global actors. If one applies international regime theory to the GIR, one may

⁸⁸ Lance A. Compa, 'Free Trade, Fair Trade, and the Battle for Labor Rights' in Lowell Turner, Harry Charles Katz and Richard W. Hurd (eds), *Rekindling the Movement: Labor's Quest for Relevance in the Twenty-first Century* (ILR Press, 2001).

⁸⁹ Pil-Su Im, 'Korea-US FTA and Labour Protection Clauses' (2011) 100 *Social Movement*.

⁹⁰ e.g. James Shoch, 'Organized Labor versus Globalization' in Lowell Turner, Harry Charles Katz and Richard W. Hurd (eds), *Rekindling the Movement: Labor's Quest for Relevance in the Twenty-first Century* (ILR Press, 2001)

have to confront its fatal weakness: the regime cannot continue over time, because strategic compromise among its relevant social actors is fundamentally vulnerable to external circumstances.⁹¹ In fact, the model of regime formation is founded upon the purely theoretical assumption that payoff calculations concerning commitment to the global regime will not change over time. Needless to say, this model could present a strong, cogent account of how the system works at the present time when the power equilibrium is stable and predictable.

However, this model cannot provide a plausible alternative to secure this operation at a point *in the future*. For example, suppose that a global environmental protection regime exists. Here, a state that suffers from an unexpected economic downturn might recalculate costs and benefits relative to its commitment to the regime; more specifically, the state can underestimate the benefits of preventing uncertain, long-term and not-yet-unfolded environmental harm, on the one hand, and overestimate the benefits of overcoming an impending economic crisis, on the other. In systems theory language, regime members are destined to be trapped in a complicated double contingency situation in which one cannot predict whether others will comply with norms in future changes in present conditions.

This problem of the global regime is also true for the GIR. The GIR is not able to operate *stably over time* as long as it is based on the coincidental power relation among relevant actors. The nation-state has formal discretion to withdraw its commitment to the GIR (dynamic inconsistency problem),⁹² as seen in some Latin American countries.⁹³ Here, suppose that many countries decide to go back to protectionism in response to public criticism over neo-liberalism. If the GIR cannot deal with such betrayal actions effectively, other actors like investors can no longer retain their normative beliefs. As the GIR becomes less attractive to investors, it cannot serve to control investment in favour of nation-states. In fact, investors could stay with host states and accept legitimate restrictions in exchange for the host state's voluntary commitment to protection from abusive restrictions. If nation-states were to retreat from the GIR as whole, investors would have no incentive to endure legitimate government regulation. Finally, the negative attitudes of nation-states could trigger the withdrawal of investors, so that the nation-states lose the minimum control which has been secured under the name of legitimate government regulation. On the other hand, civil society could take direct and extreme measures to prevent global investment, like the Occupation

⁹¹ Salacuse (n 62) p.468.

⁹² Guzman (1998) (n 73) pp.658-66; Guzman (2009) (n 73) pp.78-83.

⁹³ Bolivia and Ecuador, withdrew from the ICSID system or attempted to renegotiate the investment treaties. See Salacuse (n 62) pp.469-70.

Movement, instead of using the indirect control of the nation-states to transplant the social interests of civil society into the investment treaty. This chain of reactions destructively generates a vicious circle of mutual misunderstanding. From the perspective of systems theory, it is logically impossible that GIR members could eradicate double contingency, where one contracting party is subject to the other party's actions such as the withdrawal of normative commitments in the case of unexpected circumstantial changes.

The legal system plays a significant role in allowing actors to stick to their normative commitments despite the extreme distrust of double contingency found in the GIR. In this context, the following Section B discusses the function of law from a systems theory perspective, and then explains how the legal system can contribute to the durability of the global regime in general. Section C will then articulate the function of law within the GIR by applying this general framework to the global investment field.

B. The functional necessity of law for the durability of the global regime

Luhmann argues that the law, as a legal system, stabilises normative expectations against the changeable situations of the environment.⁹⁴ As has already been discussed, society is required to react to the disappointment of expectations. In relation to this, expectations can be categorised into cognitive expectations and normative expectations, according to the nature of the reactions (cognitive learning and normative learning) in the case of disappointments.⁹⁵ In short, cognitive expectations happen through cognitive learning, where the system learns from the experience of disappointments. In this situation, social systems can change or adjust original expectations when they realise that real situations do not meet the expectations of the systems or that meeting the expectations requires too much cost. As a result, individual social systems could survive by adapting themselves to unexpected challenges. Cognitive expectations are typical of many sub-societies which adapt the expectations of a system to unsatisfying environmental changes when experiencing disappointment.⁹⁶ For instance, scientists change their hypotheses when the experimental data prove to be different from the expected result. Compared to these cognitive expectations, normative expectations – generally called norms – do not change regardless of the

⁹⁴ Luhmann (n 39) p.148.

⁹⁵ Luhmann (n 43) p.31ff.; Luhmann (n 17) p.319ff.

⁹⁶ *ibid* p.320.

disappointment.⁹⁷ As such, the legal system does not learn from experiences, but rather holds on to original expectations.

The stabilisation of normative expectations is required because expectations *per se* are too unstable for actors to stick to them without generalisation, although expectations can play a role in abating complexity by making several possible situations expectable. Returning to the example of the intersection, suppose that driver *A* goes through an intersection without any traffic lights. The expectation in this specific situation provides driver *A* only with knowledge as to what kinds of situations will be available in the future. Therefore, the driver is allowed to expect several situations (e.g., other drivers from other directions will come up or stop but they are not supposed to suddenly disappear) and to take corresponding alternative actions (whether to stop if the other car goes on or to keep going if it stops). Despite the reduction in complexity, the driver would still be very vulnerable to any single change in the uncontrollable external circumstances – namely, others’ reactions – because they cannot be the omniscient controller of future situations. Even if driver *A* crosses the intersection safely, driver *A* cannot expect to do so every time and has to try his or her luck. This is also very much like the rock-paper-scissors game. In this game, even if the available expectations (i.e., rock, paper or scissors) are clearly imparted to every participant, nobody knows which one of the three possible gestures the other party will make. The fact that an actor *A* wins with scissors against the other party who proposes paper this time does not guarantee that actor *A* will win again with scissors the next time. In fact, there is always a risk of disappointment of expectations; indeed, the other party can propose rock the next time. Given this double contingency situation, driver *A* and the rock-paper-scissors player are always required to gamble with their ‘expectation of expectations’⁹⁸ and risk the ‘disappointments of those expectations’ as long as expectations are not generalised. By the same token, the global regime contains an ineluctable risk that mutual expectations between two actors in the global regime can go awry with the occurrence of unexpected external challenges.

Compared to this, the generalisation of expectations towards an anonymous third party allows the actors in communications to maintain the same expectations despite the risk of disappointment over a certain amount of time. For instance, traffic signs can offer a more generally applicable signal not only to driver *A* in a particular situation, but also to any driver, so that he or she can expect the same situation at any time and against any driver, as long as the drivers follow the rules. In the rock-paper-scissors game, suppose that all the participants in the game agree that

⁹⁷ Luhmann (n 39) pp.149-50.

⁹⁸ Luhmann (n 43) p.24ff.

actor *A*'s partner should give paper whenever a referee raises his or her right hand (hereafter Rule₁). In this case, actor *A* will always propose scissors against any partner whenever actor *A* sees the referee raise his or her right hand according to Rule₁. Likewise, the legal system generalises expectations by making norms which prescribe the rights and obligations of the actors.

Of course, such a rule could not extricate actors from double contingency and the risk of disappointment. Actually, traffic signs do not eliminate all risk of traffic accidents because a negligent driver could disobey or respond improperly to the sign. In the case of the rock-paper-scissors game, actor *A*'s partner has the discretion to ignore Rule₁ by proposing rock. Experiencing disappointment makes it difficult for the actors in the system to stick to the initial rule due to the mutual mistrust or misunderstanding that cripples more active attempts at communication. This mutual distrust is more common at the global level, which does not have a formal mechanism – such as a state authority at the national level – to secure enforcement and make it effective. This explains why so many global private regimes emerge and vanish in sudden political shocks.

In addition, the decisive feature of the legal system is that it can stabilise initial normative expectations by processing and absorbing disappointments within the system itself.⁹⁹ The legal system can palliate problems of double contingency below the level that impedes the possibility of further future communications between systems by elaborating a structure to process the risk of disappointment. Legal systems can maintain original expectations despite their disappointment by holding that disappointment to be illegal. Even if driver *A* is involved in a traffic accident, driver *A* can argue that he or she obeyed the traffic sign and that the other driver's behaviour was wrong (illegal) through the interpretation of the rules. As a result, despite experiencing the accident (the disappointment of the expectation), driver *A* will still take the same action based on the same expectation ('I can pass the intersection because the blue sign means that the drivers going in the other direction are supposed to stop for me') the next time. To borrow the language of systems theory, the actor does not learn from the past experience. Likewise, Rule₁ of the rock-paper-scissors game cannot eliminate the risk of disappointment that the other party does not give paper despite the third party's signal. In this case of disappointment, actor *A* would raise a claim for the violation of Rule₁ against the other party, instead of changing the expectation. This opportunity for a claim allows the very same actor to take the same action the next time when the third party raises his or her right hand. Although the legal system cannot eliminate the risk of disappointment, it can alleviate the need to change the normative expectation by transforming disappointment into a

⁹⁹ Luhman (n 43) p.40ff.

matter of legality. In order to do this, the legal system employs a specific binary code (legal/illegal) according to its own programme (conditional programme).

In this context, the law plays a creative role in making society more sustainable. As previously demonstrated, while other systems (e.g. science) change their expectations in the case of disappointment, the legal system refers to the disappointment of its expectations as an illegal situation based on the original expectations by applying a specific type of binary code to legal conflicts. Thus, the legal system helps society to deal with disappointments through the production and resolution of legal conflicts. This mechanism can condense and confirm certain expectations (norms) not only towards a particular current situation, but also towards a general future situation in a certain temporal dimension. Through the generalisation of expectations towards the future, the law could allow persons to be informed in advance of the impact their actions would have in relation to potential future cases.¹⁰⁰ Therefore, without any previous experience, one would be informed that a certain type of communication or action will be accepted successfully within a certain system. Ultimately, the legal system produces the conditions in which other sub-societies can promote and generalise their own communicative types by saving those sub-societies from the necessity of learning from experience. From a communication perspective, the legal structure can prevent disappointment from causing mutual mistrust (destructive misunderstanding) that cripples the continuity of communications. It can help maintain the belief that normative expectations will be respected by holding temporary disappointments to be illegal.

In the systems theory context, this belief can be called a *creative misunderstanding* in two respects: the belief is basically a misunderstanding, in the sense that it could be betrayed at any time because nobody can guarantee that an actor will comply with the normative expectation in the future; nevertheless, this belief is creative because it can help to produce further communications by making the actors overcome their sense of uncertainty. This function can be fulfilled by a normative belief that the legal system could not completely ignore the interests of the relevant actors, on the one hand, whilst securing a minimum scope of expectations for future actions. Here, the legal system is created not by top-down coercion for a certain actor, such as the nation-state, but by mutual and horizontal credibility among pluralised actors over normative expectations. In this setting, social actors can take an action confidently to the extent that they manage to expect a future situation in advance without any previous experience.¹⁰¹ This has an affinity with concepts such as legal certainty (*Rechtssicherheit*), which guarantees specific expectations through the maintainance

¹⁰⁰ Luhmann (n 17) p.146.

¹⁰¹ Luhmann (n 39) pp.146-48.

of consistency against any changeable situations. All things considered, it is fair to say that, to the extent that expectation is stabilised and generalised, 'one can live in a more complex society'.¹⁰²

In systems theory, the durability that the legal system secures does not mean the capacity to eliminate conflicts and induce agreement. Conversely, the legalisation of the global regime is expected to cause more conflicts; for example, more actors are allowed to raise a legal claim on the grounds of a greater variety of substantive and procedural rights. Given the absence of a control tower in the global world, the global regime will encounter more challenges and conflicts than national regimes under state authority. Conflicts cannot in any circumstance be eliminated because nobody can overcome double contingency unless totalitarianism unifies two systems into one entity. However, systems theorists do not consider conflict to be an obstacle to a social system; conversely, communication cannot happen without double contingency, which leads to divergence (conflict) between actors. Meanwhile, complete and permanent agreement runs the risk of forestalling the chances of further communications.¹⁰³ In this context, the global regime as a communicative network can be effectually functional to the extent that a cyclic chain of conflict-communication-consensus-communication can be stabilised. More specifically, conflicts should be resolved in the course of communications to produce a consensus; in turn, an established consensus should be challenged in order to provoke another communication leading to conflict.¹⁰⁴ Of course, severe and prolonged conflict or an overly adamant consensus runs the risk of blocking further communications from proceeding. Therefore, conflicts and consensus between communications should be temporalised and trivialised so as not to severely impede the connectivity of communications. All things considered, the fundamental purpose of the stabilisation of normative expectations continues to ensure communications which resolve social conflicts towards establishing a new consensus, on the one hand, while challenging extant consensus for another productive conflict, on the other hand – without the extreme outcome of the destruction of the global regime.

¹⁰² *ibid* p.148.

¹⁰³ Chernilo (n 14) pp.145-46. In a similar vein, Coser has shed light on the positive role of sustainable conflicts in cultural dialogue as they increase the chances of contact among a wide spectrum of groups. Such contact provides groups with opportunities to consciously or unconsciously reach a social consensus. See Lewis Alfred Coser, *The Functions of Social Conflict* (Routledge & Kegan Paul, 1972).

¹⁰⁴ It is on this point that systems theory decisively contrasts with traditional social contract theory. Although social contract theory considers the formation of a society or state based on a collective agreement as a fundamental goal, systems theory pays more attention to the linkage of communications, because society can exist only on condition that communications continue. Therefore, systems theory takes seriously not only consensus but also conflicts, as long as both contain the capacity to ensure communication. See Luhmann (1997) (n 11) pp.26-28.

The function of law is expected to become gradually imperative with the development of the global regime. In practice, the global regime can tackle challenges through non-legal conflict resolution and behaviour control. Although Luhmann considers behaviour control and conflict resolution as possible performances of a legal system,¹⁰⁵ no logical necessity indicates that only the legal system is allowed to dominate the role of behavioural control and conflict resolution; in aboriginal communities and medieval society, religious authorities did so, whereas many social practices or norms in the globalised world are estimated to more effectually control behaviours and resolve conflicts than state-based law. Inasmuch as one accentuates the performance of the legal system, the fundamental distinction between a non-legal normative system and the law becomes obscure.¹⁰⁶ However, the law has a specific function that cannot be undertaken by other systems: the legal system is the only sub-system that can stabilise normative expectations effectively and efficiently by processing the risk of disappointment. This function will be more necessary as the current world society has been described as a risk society, as Beck has pointed out.¹⁰⁷ Here, a global regime without a legal system cannot endure the risk of disappointment because non-legal sub-systems, such as political systems or science, will change their own original expectations in the case of disappointment. Ultimately, functional necessity for the legal system, with the increasing complexity of world society, might serve to motivate the regime to develop its non-legal normative system (social norms, customs or practices) into a legal system to stabilise normative expectations.¹⁰⁸

C. Function of global investment law

In this context, GIL is functionally essential for a long-lasting regime because the legal system stabilises normative expectations. GIL can transform a state of mutual mistrust into one of mutual credibility. Although both are fundamentally considered to be no more than mutual misunderstandings or illusions, they may lure, *or persuade*, global social actors to cooperate. Also, GIL cannot eradicate but can mitigate the risk of dynamic inconsistency problems well enough to allow communications to continue. Without the legal system, GIR members are destined to take on the costly burdens of continually changing their own expectations due to unpredictable changes in

¹⁰⁵ Luhmann (n 39) p.168.

¹⁰⁶ Galf-Peter Calliess and Moritz Renner, 'Between Law and Social Norms: The Evolution of Global Governance' (2009) 22(2) *Ratio Juris* p.264.

¹⁰⁷ Ulrich Beck, *Risk Society: Towards a New Modernity* (Sage Publications, 1992).

¹⁰⁸ In a similar vein, Luhmann anticipated that function systems under the current globalisation would be involved mainly in production of cognitive expectations. This situation will lead to the functional necessity for the each system to handle the disappointments by stabilising normative expectation. In this situation, the legal system comes into existence *with* the functional system *beyond* the local politics. Luhmann (n 43) pp.259-34.

the regime. On the other hand, the legal system reduces the burden on actors to change the originally agreed-upon consensus of normative expectations because they can challenge the legality of betrayal behaviour by other actors through the independent dispute settlement mechanism. This process renders the minimum and maximum scope of risk equally expectable to all GIR participants. It is when this expectation is calculable beforehand that all regime participants can formulate their own action plans in a stable way. For instance, a host state could decide to sign an investment treaty and accept foreign investment, because they believe that the system could guarantee the *acceptable minimum* of the legitimate exercise of sovereign power *within an expectable temporal scope*. Likewise, global investors might be able to make an investment plan when the investment treaty of the host state guarantees a generally acceptable substantive rule which the investor would feel comfortable with *within an expectable temporal scope*. Figuratively speaking, foreign investors would invest if the law were to give them a green light to do so. On the other hand, if the law were to give them a yellow light as a warning, investors might weigh the relevant risks and benefits up more carefully than when receiving a green light. Further, this function of GIL could be to create a virtuous circle of mutual credibility; once the benefits of predictability are proven to work well, it would attract more compliance, reinforcing predictability by producing a more fruitful body of cases.

IV. THE EMERGENCE OF GLOBAL INVESTMENT LAW AS A PARTIALLY AUTOPOIETIC SYSTEM

A. Global investment law as a 'law'?

As discussed above, the function of law has gradually become necessary for the durability of the global regime. The more complex the global regime is, the more imminent such functional necessity of the law may be. Eventually, functional necessity encourages the global regime to produce a (global) legal system. In turn, it could be said that the law emerges when a set of systems work to stabilise normative expectations.

However, not all normative systems produced in the course of GIR evolution can be qualified as legal systems. Like the international regime, the GIR provides many different kinds of 'principles, norms, rules, and decision-making procedures around which actor expectations

converge in a given issue-area'.¹⁰⁹ In this vein, Salacuse attempts to identify a set of principles, norms, rules, and decision-making procedures in the global investment field.¹¹⁰ He seems to identify these elements as the elements of the international (global) investment legal system without further inquiry. As discussed in the above part, it is hard to deny that the current normative system of the GIR functions as a 'law'. However, it is questionable whether the system worked as law in the past; indeed, is it possible to say that GIL existed after the establishment of the ICSID Convention, even when there were no arbitration claims? From a systems theory perspective, GIL did not emerge until its normative elements (investment treaties, arbitration procedures and doctrines) could be structured and – most importantly – could operate in an autopoietic way. This is because the law cannot stabilise normative expectations until it achieves some degree of autopoiesis. In this context, autopoiesis is considered as an important standard in identifying a legal system.

B. Global investment law as a partially autopoietic system

i) Autopoiesis of the legal system as a self-referential circularity of legal communications

Strictly speaking, social systems theory considers the law to have features of autopoiesis.¹¹¹ Luhmann argues that 'the legal system is a closed system, producing its own operations, its own structures, and its own boundaries by its own operations; not by accepting any external determination nor, of course, any external delimitation whatsoever'.¹¹² Returning to the understanding of a social system's autopoiesis as a continuum of communications, the legal system presents a circular networking of legal communications. In this context, Teubner argues that '[l]egal autopoiesis treats the legal system as a closed system of communication that can only make further legal communications out of existing ones'.¹¹³ The circularity of the law, already partially found in legal positivism, might be able to elucidate some aspects of the autopoietic phenomenon, where recognition of the law is authorised by a higher law.¹¹⁴ The validity of a legal norm is confirmed by reference not to a political or social authority, but to a legal decision, and vice versa.¹¹⁵

¹⁰⁹ Krasner (1983) (n 4) p.1.

¹¹⁰ Salacuse (n 62) pp.448-63.

¹¹¹ See generally Gunther Teubner, 'Introduction to Autopoietic Law' in Gunther Teubner (ed) *Autopoietic Law: A New Approach to Law and Society* (Walter de Gruyter, 1988); Teubner (1993) (n 7); Luhmann (n 39).

¹¹² Luhmann (n 15) p.1425.

¹¹³ Teubner (n 27) p.900.

¹¹⁴ *ibid.*

¹¹⁵ Teubner (1984) (n 7) p.259.

This self-referential feature of the legal system is associated with the systems theory argument that laws are condensed and confirmed through the process of a remembering and forgetting mechanism.¹¹⁶ As Teubner points out, '[l]aw as a system of recursive legal operations can only refer to past legal operations'.¹¹⁷ While a present communication occurs by building on past communications, this present communication is expected to be influential towards a future communication. In this process of connection, some communications may be referred to by future communications, whereas others are simply forgotten. Through the endless repetition of forgetting and remembering, a normative expectation is condensed and confirmed as a set of norms or rules which guide communicative actors in dealing with future conflicts. This forgetting and remembering operation is prevalent at the level of legal practice, as seen in *stare decisis* or *jurisprudence constante*.¹¹⁸ The common law doctrine of *stare decisis* requires a court to follow earlier judicial decisions when the same points of a previous decision are recognisable in the current case. A previous decision can be overturned not through some other extra-legal justification, but only through legal reasoning which convincingly distinguishes the current case from the previous one. Although a case, as seen in several civil law countries, does not have any precedential value that can formally bind a judge, the need for legal unity or legal consistency guides judges in new cases to take previous cases seriously. In the civil law doctrine of *jurisprudence constante*,¹¹⁹ the court pays considerable attention to a rule which is established by the accumulation of cases unless its application proves to be explicitly wrong or causes extremely unendurable injustice.¹²⁰

ii) Varying degrees of legal autopoiesis

Teubner's understanding of autopoiesis differs from Luhmann's inflexible approach which leaves no room for the idea of partial autopoiesis.¹²¹ In other words, Teubner has relativised the

¹¹⁶ Calliess and Renner (n 106) p.268.

¹¹⁷ Gunther Teubner, 'Breaking Frames: Economic Globalization and the Emergence of *lex mercatoria*' (2002) 5(2) *European Journal of Social Theory* p.211.

¹¹⁸ Teubner (1984) (n 7) p.296 (explaining the autopoietic features found in the common law system).

¹¹⁹ See generally Karl Larenz, *The Open Legal Development: Germany* in Joseph Dainow (ed), *The Role of Judicial Decisions and Doctrine in Civil Law and in Mixed Jurisdictions* (Louisiana State University Press, 1974) pp.152-156; Michel Troper and Christophe Grzegorzczak, 'Precedent in France' in Neil MacCormick and Robert S. Summers (eds), *Interpreting Precedents: A Comparative Study* (Dartmouth, 1997) pp.122-123 and p.137ff.; Mary Garvey Algero, 'The Sources of Law and the Value of Precedent: A Comparative and Empirical Study of a Civil Law State in a Common Law Nation' (2004) 65(2) *Louisiana Law Review* pp.787-92.

¹²⁰ James L. Dennis, 'Interpretation and Application of the Civil Code and the Evaluation of Judicial Precedent' (1993) 54(1) *Louisiana Law Review* (describing *jurisprudence constante* in civil law and mixed jurisdictions). See also Neil MacCormick and Robert S. Summers (eds), *Interpreting Precedents: A Comparative Study* (Dartmouth, 1997) (examining the role of legal cases in different legal systems).

¹²¹ Gunther Teubner, 'Hypercycle in Law and Organization: The Relationship between Self-Observation, Self-Constitution and Autopoiesis' in Vilhelm Aubert (ed) *EYSL European Yearbook in the Sociology of Law*

concept into three kinds of autopoiesis by introducing the hyper-cycle of general systems theory.¹²² If one applies this framework to the global regime, one could categorise the normative systems that the global regime produces as follows:

a) *Socially diffuse law*: The ‘socially diffuse law’ that exists in the early phase of legal autonomy is ‘found in conflict settlement within groups or organizations’.¹²³ Socially diffuse law is distinguishable from various social norms such as moral customs or just professional practices in the sense that a dispute settlement mechanism can resolve conflicts according to corresponding norms by using the legal binary code.¹²⁴ As previously discussed, the global regime often produces norms of a less formal style, such as codes of conduct or guidelines, and facilitates dispute settlement mechanisms to resolve the relevant conflicts in various forms of tribunal, such as arbitration or court-style tribunals. In fact, socially diffuse law is enforceable only on the condition that it incorporates the substantive extra-legal demands of state and non-state actors. As Guzman suggests, from the international law perspective, *de facto* coercion based on reputation, reciprocity and retaliation make it difficult for global regime actors to violate certain norms and decisions.¹²⁵ For example, a multinational company tends to comply with informal guidelines because human rights activist groups could damage its brand reputation by naming and shaming the company. The enforceability of those systems is secured as long as the substantive content of the system reflects the results of an equilibrium of factual power relations among the relevant actors.

b) *Partially autopoietic law*: The law can start to be partially autopoietic when some degree of self-description and self-constitution is evident. First of all, a decisive threshold between non-law (social norms) and law can be recognised in the phenomenon of self-description.¹²⁶ In a strict sense, the previously discussed socially diffuse law is not distinguishable from a social norm (or non-law) because elements of socially diffuse law are still identical with bare social elements, regardless of whether those elements can be defined by using legal language.¹²⁷ On the other hand, the legal system requires an independent rule enabling it to recognise one particular interpretation among

(Giuffrè, 1988) pp.44-45; Teubner (n 65) p.34. See also Niklas Luhmann, ‘Some Problems with “Reflexive Law”’ in Gunther Teubner and Alberto Febbrajo (eds), *State, Law and Economy as Autopoietic Systems: Regulation and Autonomy in a New Perspective* (Giuffrè, 1992) (regarding Luhmann’s comment on Teubner’s idea).

¹²² Teubner (1988) (n 11) pp.221-24. See also Teubner (1988) (n 121) p.45ff.; Teubner (65) p.30ff.

¹²³ Teubner (1988) (n 121) p.61; Teubner (1993) (n 7) p.38.

¹²⁴ Teubner (1993) (n 7) p.38.

¹²⁵ Andrew T. Guzman, *How International Law Works: A Rational Choice Theory* (Oxford University Press, 2008) pp.33-48.

¹²⁶ Teubner (1988) (n 121) p.63; Teubner (1993) (n 7) pp.38-39.

¹²⁷ Teubner (1988) (n 11) pp.222-23; Teubner (1988) (n 121) p.61; Teubner (1993) (n 7) p.38.

several contested interpretations made by social actors whilst being insulated from social influences. Legal concepts, rules and procedures are not established through direct acceptance of social interests, but through autonomous interpretation. For instance, the legal concept of property is not exactly identical to the economic concept of property; practitioners or scholars would legally interpret property in one or the other way to expand a specific economic or political interest. The legal system elicits an interpretative rule among competing arguments and reasoning pertaining to the interpretation of norms. An example of this self-description structure might be Hart's understanding of the correlation between a primary and a secondary rule.¹²⁸ A secondary rule serves as a rule for recognizing the primary rules that relate to social events. Here, the legal system can be autonomous when it is legal communication that deals with legal communication.¹²⁹ Consequently, the law cannot exist without the dynamic structure of primary and secondary rules.¹³⁰

The establishment of the partially autopoietic law requires not only self-description but also self-constitution, in that mere self-description does not sufficiently illuminate the whole picture of the self-referential features of the system;¹³¹ Indeed, the 'self-constitution of the legal system components takes place when the self-descriptions in fact become operational in controlling communications within the law'.¹³² As Teubner states, modern law institutionalises the disparity between the legal doctrines of academia or legal education and the legal practice of the judicial or legislative process. In particular, legal practice – through the use of specific legal procedure – plays a role in deciding whether or not to accept particular legal descriptions, such as legal doctrines or concepts.¹³³ However, this legal practice in everyday life would be vulnerable to social demands without the institutional structures to secure the autonomy of legal decisions. In this respect, the law is able to break with socially diffuse law when it can facilitate independent selection procedures which insulate legal practice from social influences.¹³⁴

This stage of the self-constitution of law is a crucial moment in its journey towards autopoietic autonomy because the legal system cannot determine its own course against other extra-legal impacts until it enters the phase of self-constitution.¹³⁵ Here, the law shows different degrees

¹²⁸ Teubner (1988) (n 121) p.63; Teubner (1993) (n 7) p.39.

¹²⁹ Teubner (1988) (n 121) p.63; Teubner (1993) (n 7) p.39.

¹³⁰ Teubner (1988) (n 121) p.63; Teubner (1993) (n 7) p.39.

¹³¹ Teubner (1988) (n 121) p.63; Teubner (1993) (n 7) p.39.

¹³² Teubner (1988) (n 121) p.63.

¹³³ *ibid* p.64; Teubner (1993) (n 7) pp.39-40.

¹³⁴ Teubner (1988) (n 121) p.64; Teubner (1993) (n 7) pp.40-41.

¹³⁵ Teubner (1993) (n 7) p.40.

of legal autopoiesis according to its degree of self-constitution. In addition, this self-constitution and its relevant autonomy are gradualised according to various institutional designs. To be exact, it is inversely proportional to the independence of the selection mechanism of legal doctrine from social influences. Therefore, the precise degree of autopoiesis varies in each legal system according to specific factors, such as the design type of the institutional insulation from social influence or the frequency of its practical uses.¹³⁶

c) *Perfect autopoiesis (hyper-cycle linkage)*: Teubner states that '[l]egal autopoiesis can arise only if the self-referential circles referred to above are constituted so as to link together in a self-reproductive hyper-cycle'.¹³⁷ Even if the legal system could be partly or entirely self-constituting and self-describing, it cannot be perfectly autopoietic in Maturana's sense.¹³⁸ Actually, the perfect type of autopoiesis refers to the hyper-cyclic operation, in which one self-reproducing cycle of legal components is mutually linked to other cyclic units of self-production, as in 'a self-reproductive circle of act-norm-act'.¹³⁹ More specifically, rules drawn from legal actions (deciding a case) influence the establishment of substantive and procedural norms, which further action (deciding a case) will consider in any future dispute, in a circular way. This feature of hyper-cycle linkage clearly distinguishes perfect autopoiesis from partial autopoiesis in which some parts of operations are mutually linked, whereas others are often disconnected in the partially autopoietic system.

iii) Global investment law as a partially autopoietic system

Given this framework of autopoiesis, global law is fundamentally a partially autopoietic legal system. To be exact, while Teubner finds *lex mercatoria* to be one of the most likely potential candidates for global law,¹⁴⁰ he assumes that it is just a partially autopoietic system.¹⁴¹

¹³⁶ Teubner (1988) (n 121) p.64; Teubner (1993) (n 7) p.40.

¹³⁷ Teubner (1993) (n 7) p.40.

¹³⁸ Teubner (1988) (n 121) p.64; Teubner (1993) (n 7) p.40.

¹³⁹ Teubner (1988) (n 11) p.223.

¹⁴⁰ Gunther Teubner, "'Global Bukowina': Legal Pluralism in the World Society" in Gunther Teubner (ed) *Global Law without a State* (Dartmouth, 1996); Teubner (n 117). See also Teubner (1993) (n 7) p.112; Gunther Teubner, 'Societal Constitutionalism: Alternatives to State-Centred Constitutional Theory' in Christian Joerges, Inger-Johanne Sand and Gunther Teubner (eds), *Transnational Governance and Constitutionalism: International Studies in the Theory of Private Law* (Hart Publishing, 2004) p.21; Teubner (n 57) p.332. See also Calliess and Zumbansen (n 58) pp.28-35.

¹⁴¹ Teubner (1988) (n 121) p.61; Teubner (1993) (n 7) p.38. Initially, Luhmann did not seem to show a clear position concerning existence of 'global law' although he admitted the functional necessity to stabilise normative expectations in globalisation. See Luhmann (n43) p.264.

Both global law and socially diffuse law appear to facilitate a common set of norms and dispute settlement systems. In addition, both kinds of legal system could secure *de facto* compliance and enforcement on the condition that they are able to reflect on equilibrium in social actors' power games.

Nevertheless, the defining line between global law and socially diffuse law is whether one could recognise the autopoietic structuralisation and operation of independent dispute settlement. Although global law establishes norms by accepting other social interests, it should produce consistent rules for interpreting norms separately from the direct influence of those very social interests (self-description and self-constitution).

However, global law, like socially diffuse law, does not reach the phase of perfect autopoiesis because the production of the substance of global law remains relatively open to extra-legal influences.¹⁴² For example, legal actions such as rule-making in dispute settlement are only intermittently – or even not at all – linked to norm-making action. Of course, some interpretive rules from tribunals could be incorporated into the norms by influencing the norm-making process; yet others could be forgotten or changed in the course of norm-making because social actors can change a tribunal's interpretive rules, which are extremely antagonistic to social actor interests.

Given this theoretical framework, GIL can be considered to be a partially autopoietic law.

If one analyses the evolution of GIL in its historical context, although key substantive norms and dispute settlement mechanisms were created in normative languages in the 1960s, it is very difficult to qualify the system at that time as a legal system from a systems theory perspective. A 'socially diffuse law' of the kind that Teubner describes as the first step in legal evolution is a system which can resolve investment disputes effectively using legal language.¹⁴³ In comparison, the system created in the 1960s served merely as a symbolic promise that could be arbitrarily ignored by the nation-state and was rarely employed by global investors.

In Teubner's view of legal evolution, the global investment field after the 1980s gained a critical momentum for the GIR to be able to produce socially diffuse law. The GIR in the wake of 1980s, neo-liberalism has enforced norms and dispute settlement mechanisms based on strategic rational choices, where each GIR member expects more benefits by respecting the norms and decisions of arbitrations rather than by simply ignoring them.

¹⁴² Teubner (1993) (n 7) p.41.

¹⁴³ *ibid* pp.36-38.

However, it is still unclear whether the GIR started to produce GIL as a partially autopoietic legal system. As Teubner indicates, the most important criterion is whether independent dispute settlement is autopoietically organised and operated by achieving an autopoietic nature such as self-description and self-construction; the most important criterion is whether independent dispute settlement is autopoietically organised and operated.¹⁴⁴

Investment arbitration became workable as many nation-states started to incorporate the relevant clauses into their investment treaties.¹⁴⁵ Additionally, in the wake of globalisation and the ideology of free trade, global investors more often used investment arbitration.¹⁴⁶ In the end, greater use of the system provided more chances to produce a meaningful jurisprudence so that the relevant actors would take this system more seriously. The creation of normative credibility over certain norms may be encouraged by the capacity to produce consistent and independent interpretative rules among competing arguments. Here, GIL produces its own procedures and concepts which could be shared by relevant GIR actors.

However, GIL does not reach perfect autopoiesis due to a lack of hyper-cyclic organisation and operation, and therefore a state in which this interpretative rule can be transformed into a norm in a self-referential way without external interruptions. To put it more concretely, GIL could not exist without a power equilibrium among social actors, and the autopoietic production of its elements are not automatically linked to each other. Therefore, GIL always contains an ineradicable risk that its interpretative rules could be changed through a norm-making process, such as treaty-making.

Despite this imperfect autopoiesis, global law can be still understood as a law. Needless to say, a rigorous reading of Luhmann might not qualify partially autopoietic global law as a legal system. In spite of this, if one focuses the function of law in identifying the law, one could paint a somewhat different picture; a certain normative system can be called a legal system as long as it can successfully fulfil the function of law, i.e. to stabilise normative expectations over time. Such a functionalist approach has significant implications in the sense that the global legal system might be necessary for the durability of the global regime. Regarding this, although a complete absence of autopoiesis makes this function impossible, a system with any degree of imperfect autopoiesis can sufficiently fulfil the function of law.

¹⁴⁴ *ibid* pp.38-42.

¹⁴⁵ Christopher F. Dugan, *Investor-State Arbitration* (Oxford University Press, 2008) pp.50-51.

¹⁴⁶ Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration* (Sweet & Maxwell, 2004) pp.564-65.

Partially autopoietic global law fulfils the function of law by incorporating long-term interests as normative expectations in the form of norms and by securing normative expectations against challenges caused by short-term interests in the form of independent dispute settlement. Global law cannot work efficiently as long as it absolutely refuses to reflect any degree of social interests because such a rigorous closure might risk deteriorating commitment to normative expectations. The regime should be rearranged when long-term circumstances have changed because inflexibility to such changes would make the regime unattractive to its members. Using the aforementioned global environmental protection regime as an example, suppose that a new technology was developed to permanently capture carbon dioxide. The regime might look unattractive and even unreasonable to regime members, unless obligations to cut carbon dioxide emissions were to be readjusted. Moreover, the global regime needs to be open to long-term benefits and closed to short-term challenges. In a similar vein, international regime theorists argue that a regime requires the concepts of ‘effectiveness’ and ‘robustness’ to make it more endurable.¹⁴⁷ The effectiveness of the regime attracts regime participants to stay within the regime. The regime needs robustness, or ‘the ability of the regime to withstand external threats and challenges’.¹⁴⁸ Robustness and effectiveness can be maintained when the regime can incorporate the substantial interests of regime members in the creation of normative contents, on the one hand; and when established normative contents are not easily changed by the short-term disappointments of social actors, on the other hand. Seen from this point of view, global law needs to reconcile openness to long-term benefits with closure to short-term changes in the context of the function of the law.

The global legal system can secure the effectiveness and robustness of the global regime by taking several steps. Firstly, the global law produces normative expectations (norms) which are supposed to be maintained. The norms cannot be effective unless they are responsive enough to attract regime participants from the standpoint of effectiveness. In fact, no actors could comply with normative expectations that force them to take risks that are too severe. Secondly, global law should secure normative expectations by processing the risk of disappointment in a self-referential way, separately from external social influences. If normative expectations are too changeable, the regime will look unattractive to regime participants, as those participants would not be able to calculate possible future risks. In this context, this thesis proposes that the structure of GIL consists of two elements: i) the openness of participation in norm-making; and ii) the autopoietic operation of independent dispute settlement. In this particular context, it is absurd to disqualify GIL from being a

¹⁴⁷ Andreas Hasenclever, Peter Mayer and Volker Rittberger, *Theories of International Regimes* (Cambridge University Press, 1997) p.2.

¹⁴⁸ *ibid* pp.2-3.

legal system because functionally GIL can also stabilise normative expectations through these two elements.

C. Global investment law's first element: openness of participation in norm-making

Global law requires a participation mechanism to produce substantive norms as normative expectations. These substantive norms are similar to international regime theory's understanding of norms and rules. Indeed, norms are 'standards of behavior defined in terms of rights and obligations',¹⁴⁹ and international regime theorists characterise rules as 'specific prescriptions or proscriptions for action'.¹⁵⁰ In this context, substantive norms in global law are a series of rights and obligations belonging to the relevant regime actors. These substantive norms could be established in various forms, ranging simply from statements or codes of conduct to formal bilateral or multilateral treaties.

In this context, GIL also sets up various structures through which individual actors can transplant their own sub-systemic interests into legal operations. In relation to the production of substantive norms, national procedures for participation in treaty-making could be considered to play one of the most important parts in GIL from a formal perspective. The interests of global actors are reflected by national representative institutions, such as parliament. Of course, global actors can employ various types of informal participation in norm-making at the national and global level; for example, the business interests groups can lobby treaty drafters to incorporate global investor interests into a treaty. Additionally, the model laws proposed by strong countries or NGOs and the documents (e.g. UNCTAD or OECD publications or academic journals) produced by scholars or lawyers often influence the drafting of individual treaties and the reasoning behind arbitration in a direct or indirect fashion.

This structure makes the legal system susceptible to external influences by allowing global actors to negotiate their interests through legal description, in which the legal system expresses extra-legal interests by using legal language. Such susceptibility can secure the chances of protecting a minimum scope of actors' interests through the negotiation process. The negotiation process produces normative expectations in the form of substantive norms; these prescribe that the rights and obligations of the regime participants will be respected by allowing or preventing specific behaviours. For example, the rights of foreign investors are protected to the extent that the

¹⁴⁹ Krasner (1983) (n 4) p.2.

¹⁵⁰ *ibid.*

host state is prevented from imposing severe or arbitrary restrictions on foreign investment. On the other hand, the legitimate regulatory power of the host state is respected to the extent that the concept of the public interest serves as a principle to exclude specific investor behaviour from the protectable scope of investment. Therefore, investor actions in relation to relevant rights are discouraged in practice.

In particular, the openness of participation can maintain the effectiveness of a regime by attracting global actors to the regime because it can give each global actor the expectation of an equal chance to transplant its own interests into the normative expectations. Of course, such substantive norms do not satisfy all the interests of every global actor involved because some social interests are downplayed in the course of the negotiation process. However, the relevant actors might be more likely to participate in this negotiation process to the extent that they could expect their own minimum interests to be secured, albeit that their maximum interests could not be fully realised. As world society suffers from rising uncertainty and risk, these actors might be more inclined to trade off somewhat less satisfactory normative expectations for greater predictability concerning the protection of their minimum interests. This inclination toward regime participation will be more apparent to the extent that norm-making processes are fairer and more transparent.

Through this mechanism, bare social conflicts are transformed into legal conflicts among competing legal arguments representing the rationalities of individual sub-societies. In constructing normative expectations in a legal form, each regime member prescribes substantive content by using abstract language because such abstractness may make it easier to reach an agreement that appeases the relevant actors. Therefore, the more contentious and relevant to various social interests the issue is, the more abstract and malleable the terms of treaty are. Although it is true that the abstractness of treaty terms might cause a risk of mutual misunderstanding or confusion, this abstractness makes it easier for the relevant actors to agree by increasing flexibility. Furthermore, this strategy makes the regime more effective because it opens up the possibility of future challenges and renegotiation in terms of interpretations insofar as such flexibility does not impair the long-term process of negotiation. Specifically, although regime participants will be more or less dissatisfied with certain normative expectations, they can be persuaded not to retract their commitment to the normative expectations secured because they can expect the possibility of future challenges seeking compensation for the disappointment of those expectations through an independent decision-making mechanism. To take the example of GIL, as investment treaties use many general clauses regarding obligations and rights, they leave generous room in which regime participants can renegotiate the terms in future dispute settlement. Therefore, the potential for future

challenges prevents regime actors from easily leaving the GIR and encourages more vigorous participation.

D. Global Investment law's second element: autopoietic operation of independent dispute settlement

The autopoietic operation of the dispute settlement mechanism plays a decisive role in stabilising normative expectations by screening out inappropriate external influences. Whilst the GIR cannot secure its own effectiveness when its normative expectations are insufficiently responsive to the long-term interests of social actors, it could also not maintain any temporal robustness if normative expectations were easily changed by short-term myopic challenges.

Systems theory argues that the legal system can do this job because an independent dispute settlement process can make a legal decision over the disappointment of expectations, so regime actors do not need to give up their commitment to the regime in case of disappointment. Even if a set of normative expectations are established in the form of certain substantive norms at a given point in time, the norms *per se* cannot secure normative expectations over time. Some changed circumstances risk causing a regime actor to ignore those normative expectations, resulting in a chain reaction that could ultimately cause total distrust in normative credibility due to double contingency. In response to double contingency, actors could challenge the legality of a certain action instead of giving up their normative expectations. Once legal claims are submitted, the dispute settlement mechanism reviews whether such claims are compatible with original long-term expectations (normative expectations). Also, the legal system can generalise and maintain normative expectations towards a future third party because an actor can have the same expectation next time by treating (or processing) disappointments as legal questions regarding the interpretation of normative expectations, namely as substantive norms.

In a similar vein, Guzman, from an international relations perspective, argues that an international tribunal is 'an information mechanism'¹⁵¹ with three functions. Firstly, the tribunal can help disputing parties share facts and laws to provide common grounds that might enhance the chances of conciliatory conflict resolution.¹⁵² Secondly, the tribunal can identify the violation of a specific behaviour so as to help other actors to assess and sanction the party that violates the law.¹⁵³

¹⁵¹ Guzman (n 125) pp.49-54.

¹⁵² *ibid* pp.51-52.

¹⁵³ *ibid* p.52.

Thirdly, Guzman points out the tribunal's capacity to produce consistent rules for third parties.¹⁵⁴ This function makes future risks and benefits more predictable in the longer term, serving as an incentive to stay with the regime, despite the risk that a player's interests could be compromised in the dispute settlement process.

Here, the self-referential operation of decision making is critical; a decision should be made by reference to internal sources of the system rather than to external claims, as each tribunal relies on previous legal communications (decisions) in order to deal with the present case. This inviolable chain of internal and mutual references confirms and condenses a series of consistent rules in a manner similar to a common law system. Of course, legal decisions in most global legal systems do not have any formal legal effect on future decisions, unlike the *stare decisis* of common law countries. However, tribunals established for the adjudication of global law show a self-referential feature that is similar to the doctrine of *jurisprudence constante*.¹⁵⁵

The autopoietic operation of the dispute settlement mechanism is observable in the global investment field. GIL produces a consistent interpretative rule through the forgetting and remembering process of a network of legal communications (i.e. legal decisions). Individual decisions in the arbitration process do not have any formal legal effect to bind later decisions nor are they part of any official hierarchy.¹⁵⁶ Indeed, many arbitration tribunals have been reluctant to recognize the formal binding effect of previous decisions.¹⁵⁷ Despite this, in reality the decisions of international investment arbitrations are linked in a self-referential way, in that tribunals tend to cite previous decisions whenever this helps to interpret the text of a specific treaty.¹⁵⁸ In practice, a significant number of individual arbitrators treat the previous decisions of other arbitrations as *de*

¹⁵⁴ *ibid* p.54.

¹⁵⁵ Gabrielle Kaufmann-Kohler, 'The 2006 Freshfields Lecture—Arbitral Precedent: Dream, Necessity, or Excuse?' (2007) 23(3) *Arbitration International*.

¹⁵⁶ *ibid* pp.368-69; Andrea K. Bjorklund, 'Investment Treaty Arbitral Decisions as Jurisprudence Constante' in Colin Picker, Isabella Bunn and Douglas W. Arner (eds), *International Economic Law: The State and Future of the Discipline* (Hart, 2008) p.268; Salacuse (n 62) p.460.

¹⁵⁷ Christoph Schreuer, 'Diversity and Harmonization of Treaty Interpretation in Investment Arbitration' in M. Fitzmaurice, O. A. Elias and Panos Merkouris (eds), *Treaty interpretation and the Vienna Convention on the Law of Treaties: 30 Years on* (Martinus Nijhoff Publishers, 2010) pp.139-45 (describing the general attitude of investment arbitration regarding precedential values).

¹⁵⁸ *AES Corporation v. The Argentine Republic*, ICSID No. ARB/02/17, Decision on Jurisdiction, 26 April 2005 para.30; *El Paso Energy International Company v. The Argentine Republic*, ICSID No. ARB/03/15, Decision on Jurisdiction, 27 April 2006 para.39. See also Christoph Schreuer and Matthew Weiniger, 'A Doctrine of Precedent?' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) pp.1191-95; Salacuse (n 62) p.461. See also Jeffery Commission, 'Precedent in Investment Treaty Arbitration: A Citation Analysis of a Developing Jurisprudence' (2007) 24(2) *Journal of International Arbitration* (conducting empirical research regarding the citation of previous cases).

facto precedents much like the *jurisprudence constante* principle.¹⁵⁹ As the *Saipem* tribunal points out,¹⁶⁰ arbitrators pursue legal certainty and consistency through legal harmonisation.¹⁶¹

The behaviour of individual arbitrators in pursuing legal harmonisation cannot be adequately explained solely by reference to professional moral duty. In fact, this GIL mechanism is legitimated not by top-down authority but by persuasiveness from the horizontal networking of GIR members. Therefore, GIL is highly sensitive to impartiality, which can persuade GIR members to concur with its legal certainty. The arbitration system will become fragile or even defunct in the future if it shows any apparent bias in favour of a particular group.

The systemic requirement for legal impartiality and certainty makes individual arbitrators subject to an anxiety over reputational damage.¹⁶² In practice, individual arbitrators consider reputational value to be one of the most important factors in enhancing their chances of reappointment and which have a great influence on the arbitration process. If an arbitrator is branded as biased, they might be gradually ostracised from the arbitration industry.¹⁶³ Therefore, in this dynamic, individual arbitrators attempt to enjoy benefits of the network effect¹⁶⁴; in GIL, the abstract languages of the treaty leave broad scope for interpretative choices, whereas the prescribed languages are remarkably similar to each other. Given this situation, arbitrators are inclined to favour more reputable and less extreme interpretations of other institutions, such as ICSID, which are more acceptable to both claimants and host states, in order to circumvent criticisms of national bias or lack of expertise.¹⁶⁵

¹⁵⁹ Bjorklund (n 156).

¹⁶⁰ *Noble Eenergy Inc and MachalaPower Cia Tida v. Ecuador and Consejo Nacional de Electricida*, ICSID No. ARB/05/12, Decision on Jurisdiction, March 5, 2008 p.50; *Saipem S.p.A. v. People's Republic of Bangladesh*, ICSID No. ARB/05/7, Decision on Jurisdiction and Recommendation on Provisional Measures, March 21, 2007 para.67.

¹⁶¹ Bjorklund (n 156) p.277; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) pp.35-38; Montt (n 78) p.106; Salacuse (n 62) p.461; Schreuer (n 157) p.139.

¹⁶² Charles N. Brower and Stephen W. Schill, 'Is Arbitration a Threat or a Boom to the Legitimacy of International Investment Law' (2009) 9(2) *Chicago Journal of International Law*.

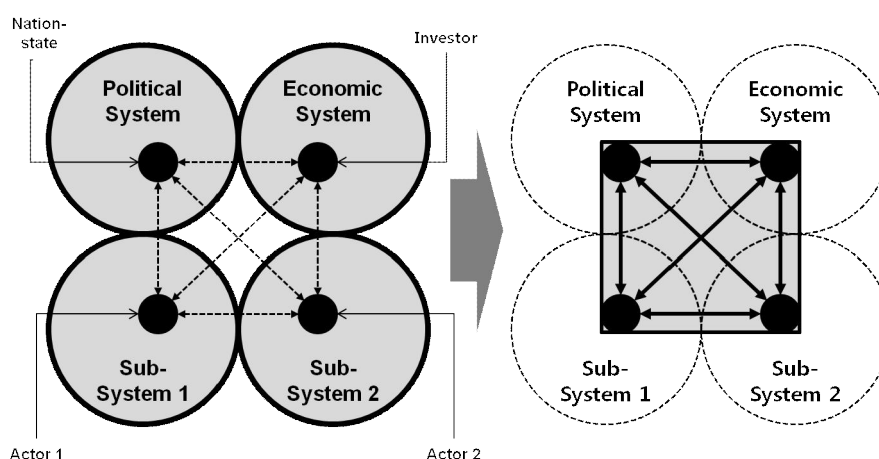
¹⁶³ *ibid* pp.489-95.

¹⁶⁴ Montt (n 78) pp.105-08.

¹⁶⁵ Bjorklund (n 156) pp.276-77; Salacuse (n 62) p.416.

V. CONCLUSION

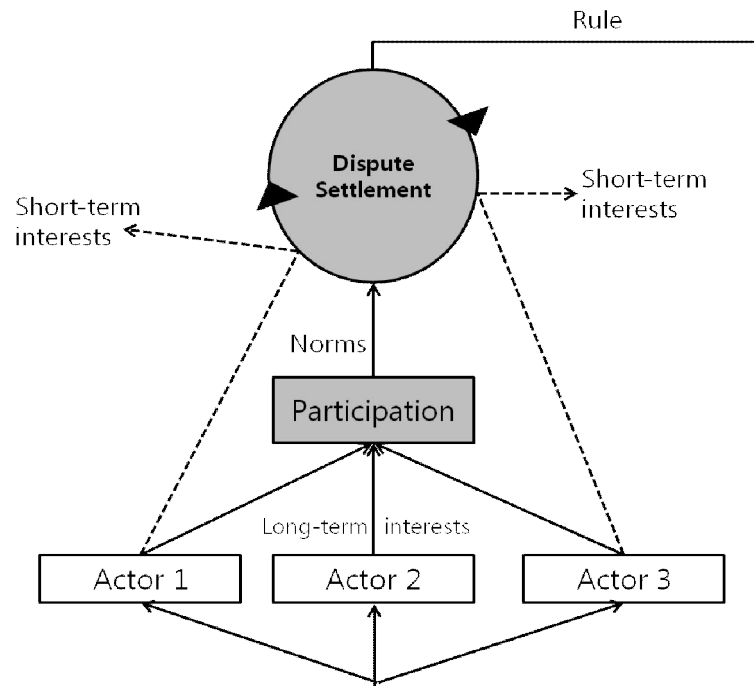
GIL is formed by the conditions caused by functional differentiation in which the political system – mainly based on the nation-state – is deteriorating to the extent that other sub-systems are mushrooming across the world. In this situation, the GIR has emerged as a grand global bargaining tool among global actors (states, investors and civic groups) representing the rationalities of relevant sub-societies (e.g., nation-states for the political system, commercial investors for the economic system). Although they emulate one another in an attempt to control the global investment field, they cannot exist without the cooperation of the others. Ultimately, these actors can enjoy the long-term benefits of cooperation and self-compliance by establishing a GIR, despite the risks of short-term loss, in order to avoid the worst scenario (See Figure IV-1).



<Figure IV-1> Formation of the Global Investment Regime

As the regime further evolves, the achievement of its longevity stipulates the effectiveness and robustness of the system through the function of GIL, which is to stabilise normative expectations. Therefore, the normative expectations upon which regime members agree should not be too vulnerable to frequent changes, whereas they should be responsive to the long-term interests of regime participants. As a result, the global law consists of two structures (see Figure IV-2). Firstly, it requires a participation mechanism to translate the various social interests into norms. As this mechanism is designed to be open to more varied social interests, the system could gain more *de facto* legitimacy and effectiveness. Secondly, as the mechanism of independent dispute settlement is autopoietically structured in light of self-constitution, it can allow regime actors to challenge disappointing situations in the form of legal claims rather than simply withdrawing from the regime itself. In facing challenges, the autopoietic rule-making of the independent dispute settlement mechanism can protect original expectations by rejecting the short-term influences of the

very challenging actors (see the dotted lines in Figure IV-2), as long as the legislative body does not change the rule officially through participation.



<Figure IV-2> Structure of Global Investment Law

Viewed in this light, GIL is not what exists separately from national or international law. Indeed, GIL is incarnated only by the implementation or application of specific national or international laws dealing with a certain global investment issue, namely the relation between investment protection and restriction. Therefore, state-based laws, such as international and national laws or private norms, are not always excluded from global law as long as they are related to elements of GIL. For example, national legal procedures for creating an international treaty would be considered a structural part of the participation mechanism of GIL formation. In addition, GIL cannot be dissolved into a bundle of national or international laws. The law can exist as long as it can fulfil its function (e.g. generalisation of expectations) to handle disappointments.¹⁶⁶ Simple ‘material formation of the content of legal tenets and the conceptual-doctrinal construction of their contexts’ would not significantly avail for recognition of legal system.¹⁶⁷ The legal system can be observable when legal elements and actions are structuralised and operated an autopoietically. It

¹⁶⁶ Luhmann (n 43) p.263-64

¹⁶⁷ Luhmann (n 43) p.264.

can be inferred from this analysis that GIL is a *hybrid* system that has developed beyond any of the traditional distinctions such as state/non-state, public/private, or official/non-official laws. GIL has come to have emerging properties through the dynamic interplay of global actors who implement and apply national or international laws.

Despite evidence of the existence of a GIL, this chapter leaves unanswered several crucial questions pertaining to the alternatives available to the Korean government, especially from the perspective of indirect expropriation concerns. As discussed earlier, some worry that the nation-state will lose all control over foreign investment because it will delegate its own sovereign powers to the global legal structure. Further, global law runs the risk of ignoring public interests or other social values because the global legal system is too vulnerable to a business-oriented thrust in investment arbitration in applying indirect expropriation rules. Given the current situation of global investment legal practices, these concerns look more convincing; in fact, a series of global recessions have provided opportunities to reflect upon pre-existing legal practices in the global investment field. In other words, the current situation pertaining to the global economy and national politics appears to challenge the formula of the Washington Consensus, that absolute freedom of global investment must bring about national prosperity, despite this neo-liberal belief encouraging many nation-states to conclude international investment treaties in the 1980s.¹⁶⁸

In this context, research must address the question of whether the nation-state should promote or discourage the development of GIL. If it should, what direction should the nation-state take regarding public welfare?

In this regard, the following chapter will analyse the regulatory trilemma in which the nation-state steps down from its dominant position so that it suffers from difficulties in controlling sub-systems and the resulting conflicts. Given this situation, this thesis suggests that the current nation-state can expect the predictability of its minimum national interests through creative use of GIL. Of course, the thesis will recognise the existence of a gap between ideal GIL and its current development. In this context, the thesis will discuss constitutionalism as providing a theoretical framework to help us to come up with alternatives to reduce such a gap between reality and theory and to provide more benefits for relevant global actors, including the nation-state, in the GIR.

¹⁶⁸ Salacuse (n 62) pp.470-71.

CHAPTER V

CONTEXTUAL CONTROL OF THE GLOBAL INVESTMENT REGIME THROUGH THE CREATIVE USE OF GLOBAL INVESTMENT LAW AND STRUCTURAL COUPLING

I. INTRODUCTION

This chapter examines a series of alternatives available to the Korean government in dealing with so-called indirect expropriation concerns. Chapter III has demonstrated that mere substantive doctrinal similarity between the KORUS-FTA and the Korean Constitution cannot circumvent the fundamental risk of indirect expropriation claims. It has highlighted that this is because such similarity cannot eliminate all possibility of interpretative conflict over the same treaty text between the host state and a foreign investor.

Systems theory understands this phenomenon as a rationality conflict among various sub-systems.¹ More specifically, conflicts among social sub-systems are transformed into interpretative conflicts among actors who present their own sub-systems through provisions of the same treaty in dispute settlement proceedings. Applying this understanding to the context of indirect expropriation concerns, a global investor, as an agent of the economic system, attempts to narrow the scope of the host state's legitimate regulatory power order to expand the conceptual scope of indirect expropriation. On the other hand, the host state, as an agent of the political system, argues for

¹ Gunther Teubner, 'A Collision of Discourses: Foreword' in Richard Nobles and David Schiff (eds), *Understanding Miscarriages of Justice: Law, the Media, and the Inevitability of Crisis* (Oxford University Press, 2000); Gunther Teubner and Andreas Fischer-Lescano, 'Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law' (2004) 25(4) *Michigan Journal of International Law*.

broader interpretation of that legitimate regulatory power to control global investment in accordance with its political interest.²

The fundamental problem for the nation-state occurs in the structure of independent dispute settlement, which the nation-state cannot entirely control. In the event of conflict, the nation-state and the investor agree to resort to an independent dispute settlement mechanism, which operates without any national bias. This independent mechanism allows individual investment tribunals to resolve relevant legal conflicts by reference to other investment decisions, rather than by reference to other national legal sources. Under this independent mechanism, the gradual accumulation of cases confirms and condenses a series of autonomous interpretative rules. Therefore, international investment tribunals have the discretion to invalidate a constitutionally justifiable government action on the ground of a breach of the treaty by relying on an autonomous interpretative rule of indirect expropriation. Consequently, a government action taken according to the Korean Constitution becomes subject to the tribunal of investor-state arbitration.

In this regard, the previous chapter has articulated particular rationales that drive an individual sovereign state to delegate its own power of conflict resolution to a transnational mechanism. In that chapter, systems theory provided the GIR and GIL as theoretical frameworks to explain the global prevalence of investment treaties and investor-state arbitration.

Although this explanation describes the development of GIR and GIL to date, it does not address whether this development is desirable for the nation-state, and ultimately for the public.³ In response to such challenges, the Australian government has recently stated that it will not adopt clauses for investor-state dispute resolution into future trade agreements according to the principle that it will not ‘support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses’.⁴

Indeed, there are many policy choices available to nation-states to regulate the global investment field. For example, a nation-state can protect or restrict foreign investment under

² Alice De Jonge, *Transnational Corporations and International Law: Accountability in the Global Business Environment* (Edward Elgar, 2011) pp.73-74.

³ See generally David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge University Press, 2008).

⁴ Department of Foreign Affairs and Trade in Australian Government, ‘Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity’ (2011) p.14 <<http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf>> accessed 15 April 2012

national law and resolve relevant conflicts according to national legal proceedings without any investment treaties or investment tribunals. Although negotiating states make investment treaties, they can allow a national court to adjudicate cases raised under a treaty, rather than delegating this task to a transnational mechanism.

Despite the many different policy choices available for the regulation of global investment, nation-states continue to deal with global investment problems indirectly through reliance on global norms and dispute settlement mechanisms; why? To put it differently, why should those actors give up direct control over achieving specific substantive goals? In light of the current global economic downturn, does more direct political intervention sound like a more convincing alternative? This is associated to another question; will an ambitious policy for nation-state control over global investment (whether by promotion or restriction) without reliance on the GIL be successful?

In order to answer these questions, this chapter starts by discerning whether individual nation-states can maintain perfect control over the global investment field as a GIR emerges. It explains that the neo-liberal model in favour of the absolute freedom of global investors and a welfare-state model in favour of complete control over global investment, are both destined to fail in the GIR. Relying on that analysis, Part III shows that the nation-state can assume contextual control in a manner that lies between rigorous direct control and laissez-faire policies by using the autonomy of GIL. It highlights that individual states can secure minimum predictability over global investment through the creative use of GIL to attract global investment within controllable levels. Part IV demonstrates that the legal autonomy of GIL can be secured through global constitutionalism to secure balanced structural couplings between the state, law and other regulated societies. The Part V demonstrates that the concept of global constitutionalism provides meaningful insights for global and national constitutional alternatives which the Korean government can adopt.

II. CONTEXTUAL CONTROL OF THE GLOBAL INVESTMENT REGIME THROUGH GLOBAL INVESTMENT LAW

A. Input-output model of the nation-state

The modern system of global investment in the 20th century experienced two seemingly opposing approaches to its management: the welfare-state model approach and the neo-liberal model approach.

The welfare-state model in the global investment field shares many features with the traditional modern welfare state at the national level.⁵ Firstly, this model presumes that the nation-state has the primary competence to control other social fields within its territorial boundaries. At the national level, the welfare state attempted to increase the capacity of the state to perform public tasks. The state, especially after the Great Depression, was required to perform numerous interventionist tasks in many societal areas in order to meet needs for economic prosperity, public health and public education. In exchange for various public services, people supported the state's authority to organise society under the symbolic unity of the nation-state. Public demand for services requires the nation-state to adopt more technical and intrusive measures.⁶ This welfare-state model may be applicable to the global investment field. For example, the nation-states established ambitious state-driven plans for national economic prosperity in order to gain popular support. In accordance with key Keynesian lessons, many developing countries increased their domestic demands by protecting their weak national industries, rather than by attracting foreign investment. Meanwhile, host states attempted to control global investment within its borders with regulatory techniques aimed to prevent global investors from ignoring the host state's national interests.⁷ Some developing countries imposed national legislation to restrict foreign investment within their territory and behaved aggressively towards foreign investment by, for example, subjecting it to nationalisation.⁸ At the international level, this trend led to a greater emphasis on the power of the nation-state in legal practice in the international investment field. In particular, resource nationalism and the emergence of the 'third world' increased the diplomatic strength of investment-importing countries against a number of original investor states. Such political influence, under the banner of the 'Calvo Doctrine'⁹ and the 'New International Economic Order'¹⁰, had an important role in giving more weight to sovereign dignity. Latin American

⁵ See generally Pierre Pestieau, *The Welfare State in the European Union: Economic and Social Perspectives* (Oxford University Press, 2006).

⁶ Robin Stryker, 'Globalization and the Welfare State' (1998) 18(2/3/4) *International Journal of Sociology and Social Policy* pp.5-6; Peer Zumbansen, 'Law after the Welfare State: Formalism, Functionalism, and the Ironic Turn of Reflexive Law' (2008) 56(3) *American Journal of Comparative Law* pp.785-86.

⁷ Jeswald W. Salacuse, 'From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World' (1999) 33(4) *International Lawyer* pp.877-82.

⁸ Rhys Jenkins, 'Corporate Codes of Conduct: Self-regulation in a Global Economy (UNRISD Programme Paper)' (2001) pp.2-3

<[http://www.unrisd.org/unrisd/website/document.nsf/0/e3b3e78bab9a886f80256b5e00344278/\\$FILE/jenkins.pdf](http://www.unrisd.org/unrisd/website/document.nsf/0/e3b3e78bab9a886f80256b5e00344278/$FILE/jenkins.pdf)> accessed 15 April 2012. See also Bob Hepple, 'A Race to the Top? International Investment Guidelines and Corporate Codes of Conduct' (1999) 20(3) *Comparative Labour Law & Policy Journal* pp.353-54.

⁹ Christopher K. Dalrymple, 'Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause' (1996) 29(1) *Cornell International Law Journal* pp.164-69.

¹⁰ G. W. Haight, 'The New International Economic Order and the Charter of Economic Rights and Duties of States' (1975) 9(4) *International Lawyer*; Robin C. A. White, 'A New International Economic Order' (1975) 24 *International & Comparative Law Quarterly*.

countries, influenced by the Calvo Doctrine, preferred national judicial mechanisms to resolve conflicts between host states and foreign investors. In addition, many developing countries questioned the Hull formula which requires ‘prompt, adequate, and effective’ compensation for expropriation, by arguing for more sovereign control over the treatment of investment within a state’s territorial jurisdiction.¹¹ On the other hand, the investors of developed countries who had lost their colonies suffered from many difficulties in seeking a suitable place to make investments. Consequently, investors engaged in risky investments, despite arbitrary changes of regulation in newly independent states, as long as the host states could offer attractive advantages such as cheap labour forces or natural resources unavailable elsewhere.¹²

When the welfare state model was prevalent, the nation-state could secure strong control over global investment. Whether the welfare-state model of investment policies was absolutely indifferent to attracting foreign investment was somewhat unclear. Historically speaking, many nation-states had signed bilateral investment treaties (e.g. the one between Germany and Pakistan in 1959) and joined the regime of the ICSID Convention for investor-state arbitration (1966) in the zenith of the welfare-state model. Nevertheless, major developing countries such as China, Brazil and India took passive attitudes towards BITs until the 1980s.¹³ Additionally, most BITs at that time incorporated state-to-state arbitration which cannot be raised by a private investor alone. This situation persisted until the Indonesia-Netherlands BIT (1968) and Chad-Italy BIT (1969) were concluded with investor-state arbitration clauses.¹⁴ Even where treaties prescribed investment protection or independent dispute settlements, in practice this served as mere ornamentation due to lack of enforcement. Of course, non-compliance behaviour by the host state (i.e. an arbitrary retreat from contractual commitments, breaches of treaty provisions, or rejecting execution of arbitration award) could impair their global reputation or lead them to face diplomatic pressures from other states. Nevertheless, host states simply weighed up the possible reputational damage occasioned by regulatory changes against the expected benefits of the relevant public policy. In this cost-benefit calculation, reputational damages or the possibility of hostile reactions from other states may have looked relatively trivial to host states; global investment practices in the era of the welfare-state model principally respected the sovereign power of the host state. In addition, the major economic

¹¹ Andrew T. Guzman, ‘Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties’ (1998) 38(4) *Virginia Journal of International Law* pp.644-51; Andrew T. Guzman, ‘Explaining the Popularity of Bilateral Investment Treaties’ in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment* (Oxford University Press, 2009) p.74.

¹² Guzman (1998) (n 11) pp.673.

¹³ Andrew Paul Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International, 2009) pp.43-44

¹⁴ *ibid* pp.44-45

policies of many investment-importing states showed a general tendency to prioritise protectionism over the attraction of foreign investment. At least they, like Korea in 1960s, attempted to maintain quite tight control over the flow of foreign capital although it was interested in attracting more foreign capital.¹⁵

In this situation, investors tended to endure regulatory changes because direct challenges against host state action could be costly. For example, the retaliatory withdrawal of investment was not a simple endeavour. Additionally, foreign investors lacked credible enforcement through investment legal mechanisms; for example, they lacked confidence in the fairness of tribunal reviews and states' willingness to respect any consequent award. More importantly, foreign investors were unable to expect predictability due to a dearth in consistent case law. In practice, legal action was risky due to tacit regulatory hostility from the host state. In this context, it might be fair to say that global investment was generally subject to the ultimate control of nation-states or international relations in the sense that investor rights under treaties were *de facto* no more than gentlemen's agreements or kindnesses that the host state could revoke at any time.

On the other hand, the neo-liberal model posits that the nation-states can make the liberalisation of global investment conducive to national prosperity through deregulation or investment protection. Indeed, the welfare-state model trend seems to have come to an end as states' abilities have deteriorated at both domestic and global levels. Since the 1970-1980s, the welfare-state model has faced serious challenges.¹⁶ Nation-states do not seem to be able to coordinate social needs and interests or control social conflicts. The welfare-state model is based on a grand compromise between the government and big social organisations like trade unions. Thus, people support political authority in exchange for the expectation that the political system can provide social services for the public. As state capacity has deteriorated, the trade-off between political justification and the provision of the social benefits has ceased to work effectively.¹⁷ This crisis is

¹⁵ Dong-Myeon Shin, *Social and Economic Policies in Korea: Ideas, Networks and Linkages* (Routledge, 2003).

¹⁶ See generally David Harvey, *A Brief History of Neoliberalism* (Oxford University Press, 2005).

¹⁷ Gunther Teubner, 'The "State" of Private Networks: The Emerging Legal Regime' (1993) 1993(2) *Brigham Young University Law Review* p.567. See also Jürgen Habermas, *Legitimation Crisis* (Heinemann, 1976) pp.33-94; John Paterson, 'Reflexive Law: Challenges and Choices' in Galf-Peter Calliess and others (eds), *Soziologische Jurisprudenz Festschrift für Gunther Teubner zum 65. Geburtstag* (De Gruyter Recht, 2009) pp.561-63.

exacerbated by globalization because nation-state control does not work well where previously territorially restricted national economies have become intertwined in the global economy.¹⁸

Nation-states have responded to this situation through the widespread delegation of their own powers to market-oriented institutions or global civil society.¹⁹ As nation-states step back from omnipotent rule over every social affair, they delegate their traditional regulatory role to other independent mechanisms at the national and global levels. This strategy has finally become popular in the global investment field, as the attitude toward global investment has fundamentally changed.²⁰

The modern legal regime for international investment took shape against this historical background, though its origins appear ambiguous. After the 1980s, many developing countries changed their economic policies, trying to use foreign investment to promote the domestic economy.²¹ For example, in the early 1990s many countries changed their national regulatory climates toward liberalisation to relax or remove restrictions on foreign investment.²² At the international level, they promised investment protection through international investment treaties such as NAFTA in order to attract greater foreign investment.²³ Over the last two decades the number of BITs concluded has substantially and rapidly increased from less than 400 to over 2000.²⁴ Nation-states voluntarily signing BITs have made sovereign decisions to delegate their powers over conflict resolution to international mechanisms such as the ICSID system.²⁵ Although the ICSID Convention was initiated by major investment-exporting countries in an effort to protect their own investments from the national bias of developing countries, neo-liberal economic policies substantially encouraged many developing countries to voluntarily guarantee this type of

¹⁸ Stryker (n 6) pp.6-11.

¹⁹ Teubner (n 17) pp.567-71.

²⁰ Rhys Jenkins, 'Globalization, Corporate Social Responsibility and Poverty' (2005) 81(3) *International Affairs* (Royal Institute of International Affairs 1944-) pp.526-28.

²¹ Thomas W. Wälde, 'A Requiem for the "New International Economic Order": The Rise and Fall of Paradigms in International Economic Law' in Najeeb Al-Nauimi and Richard Meese (eds), *International Legal Issues Arising under the United Nations Decade of International Law* (Martinus Nijhoff Publishers, 1995); Hepple (n 8) p.3.

²² UNCTAD, 'World Investment Report 1995: Transnational Corporations and Competitiveness' (1995) pp.272-74 <http://www.unctad.org/en/docs/wir1995_en.pdf> accessed 15 April 2012. See also Iain Pirie, *The Korean Developmental State: From Dirigisme to Neo-liberalism* (Routledge, 2008) pp.137-142 (describing Korean efforts to attract more foreign direct investment since the IMF Crisis).

²³ Salacuse (n 7) pp.882-89.

²⁴ UNCTAD, 'Recent Developments in International Investment Agreements' (2009) p.2 <http://www.unctad.org/en/docs/webdiaeia20098_en.pdf> accessed 15 April 2012.

²⁵ Todd Allee and Clint Peinhardt, 'Delegating Differences: Bilateral Investment Treaties and Bargaining over Dispute Resolution Provisions' (2010) 54(1) *International Studies Quarterly*.

independent dispute settlement in order to send positive signals to foreign investors.²⁶ In addition, global investors increasingly started to employ investor-state arbitration over treaty-based disputes under the ICSID Convention or other ad hoc arbitration mechanisms over the 20 years after the first case was raised in 1987.²⁷ Such more frequent use of investor-state arbitration and host state's respect of international investment law generated a virtuous circle to persuade more global investors to rethink the normative potential of investor-state arbitration.

The neo-liberal model gained prominence due to the bitter lessons of the welfare-state model. Nevertheless, both models share fundamentally common characteristics in regulating global investment. Firstly, the two models are based on very strong political aspirations. For example, the supporters of the welfare-state model believe that the nation-state can control global investment in favour of national prosperity through heavy regulation. Similarly, the neo-liberal model is motivated by the strong political expectation that deregulation or property protection will bring about greater national prosperity.²⁸ In addition, these two political beliefs derive from the deeply rooted myth that globalised investment will respond in a causal way to such political expectations. Secondly, this mechanical causation expected under both models between regulation and its effects ignores the emerging autonomy of the social sphere. Lastly, the two models attempt to instrumentalise the legal system in order to achieve specific political goals. For example, the welfare-state model arbitrarily ignores international laws related to the protection of foreigners in the course of nationalising or regulating foreign investments. The same is true of the neo-liberal model; even if the neo-liberal approach pretends to take no action regarding the private sector, in reality history shows that the neo-liberal state had played an active role in exercising disciplinary power over various social spheres such as labour or the environment in order to create good business environments.²⁹ Therefore, the neo-liberal legal model has impaired the legal formalism

²⁶ Jeswald W. Salacuse, 'Is There a Better Way-Alternative Methods of Treaty-Based, Investor-State Dispute Resolution' (2007) 31(1) Fordham International Law Journal pp.151-52.

²⁷ UNCTAD, 'UNCTAD IIL Issues Note: Latest Developments in Investor-State Dispute Settlement' (March 2011) p.2 <<http://www.unctad.org/Templates/Page.asp?intItemID=6205&lang=1>> accessed 15 April 2012.

²⁸ Some critical commentators argue that neo-liberalism is little more than a political project to restore the class power of capitalists or that it is an ideologically driven blueprint. In any case, it may be undeniable that neo-liberal policies were mainly politically motivated. See Harvey (n 16) p.19; Nik Heynen and others, 'Introduction: False Promises' in Nik Heynen and others (eds), *Neoliberal Environments: False Promises and Unnatural Consequences* (Routledge, 2007) pp.2-9.

²⁹ See generally Schneiderman (n 3). See also James McCarthy, 'Privatizing Conditions of Production: Trade Agreements as Neoliberal Environmental Governance' in Nik Heynen and others (eds), *Neoliberal Environments: False Promises and Unnatural Consequences* (Routledge, 2007) (explaining environmental protection and investment protection in the context of international investment law). In fact, neo-liberalists seem to consider the nineteenth-century in Britain as 'an age of the laissez-faire' or their 'paradise lost'. However, the historical analysis of the government practices in many areas at that time shows mixed evidence in terms of state intervention although the nineteenth century politicians and theorists at that time had a strong

which generates a balance between economic value and other social values, such as environmental protection, under the banner of investment protection.³⁰

In this context, this study argues that the two models could be categorised as input-output models, which presume that regulation as an external input into a system is causally related to a corresponding output, that is, the system's response to that regulation. Also, this model presumes that the regulator has the cognitive capacity to see through this mechanical formula between the regulation and its regulatory result. For example, the neo-liberal and welfare-state models, as input-output models, believe that the nation-state can achieve an intended policy goal, such as national prosperity, through a series of measures in the global social field. Despite their different substantive contents, both the welfare-state and the neo-liberal models are adopted by nation-states on the basis of the same presumption: the social field is supposed to react to finely-tuned regulatory actions in a causal manner with specific substantive goals.

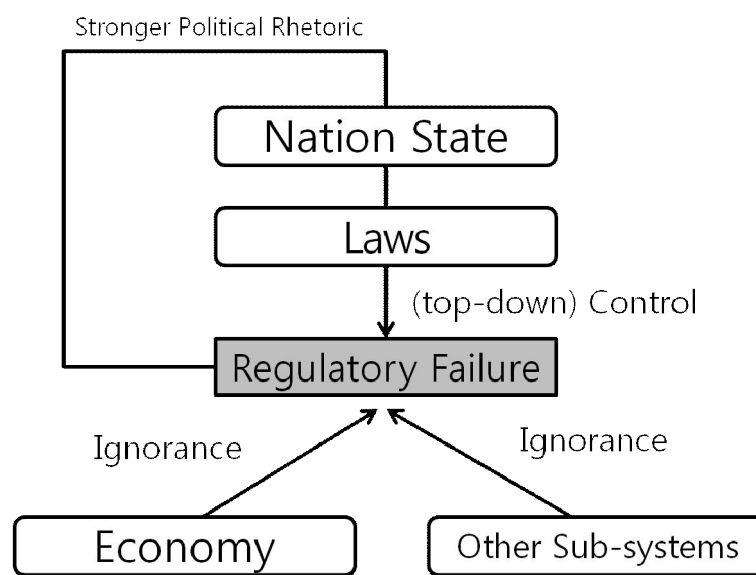
B. Global regulatory trilemma of nation-states in the global investment regime

Given the dynamic of GIR formation, the nation-state is destined to suffer from a vicious circle of regulatory failure as long as its regulation skills remain based on the input-output model. As discussed above, the GIR is established by global actors belonging to autonomous sub-societies. In this situation, the autonomy of the global social field does not allow the nation-state to anticipate outcomes in advance. Nevertheless, the use of the input-output model means the nation-state is attempting to control such unpredictable global social fields by dominating the legal system. In practice, autonomous social systems simply ignore the legal system which is subjugated by political interventions. Finally, this situation forces the nation-state to face regulatory failure; for example, under the welfare-state model, global investors simply withdrew their investment in order to avoid heavy regulation. In the neo-liberal model, global investors exploited deregulation policies simply ignoring national interest. The recent global economic crisis has proved that the uncontrollable expansion of the global monetary sector under neo-liberal protection has harmed the national real

belief in the value and potential of laissez-faire policies. See Arthur J. Taylor, *Laissez-faire and State Intervention in Nineteenth-century Britain* (Macmillan, 1972), pp.53-64.

³⁰ Harvey (n 16) pp.64-86. See also Stephen Gill, 'Globalisation, Market Civilisation, and Disciplinary Neoliberalism' (1995) 24(3) *Millennium – Journal of International Studies*; Stephen Gill, 'The Global Panopticon? The Neoliberal State, Economic Life, and Democratic Surveillance' (1995) 20(1) *Alternatives: Global, Local, Political*. See also Raymond Plant, *The Neo-liberal State* (Oxford University Press, 2010) (proposing a critical analysis of the theoretical promises and practical weaknesses of the neo-liberal position on the rule of law and the role of the state).

economy.³¹ Nonetheless, nation-states have responded to this with stronger political rhetoric for heavier regulation or more deregulation, although such short-term remedies supposedly do not work effectively. In the end, the nation-state cannot escape from this vicious circle, in which regulatory failure brings about stronger but hopeless political intervention which is destined to cause another regulatory failure (see Figure V-1). What is worse is that this increased political pressure risks deconstructing the regime itself. As noted above, the relevant actors cannot make unlimited concessions to political interests because the creation of the regime is based on a mutual trade-offs between actors including nation-states. Finally, the regime itself might gradually come to look unattractive to global investors as economic loss aggravated by politically-dominated agreement apparently surpasses the benefits from commitment to the regime itself.



<Figure V-1> Regulatory Failure under the Input-Output Model

Systems theory explains this regulatory failure by using the term ‘regulatory trilemma’, which is a cacophonous incongruence among political, legal and regulated sub-societies.³² More

³¹ Gunther Teubner, ‘A Constitutional Moment? The Logics of “Hit the Bottom”’ in Poul F. Kjaer, Gunther Teubner and Alberto Febbrajo (eds), *The Financial Crisis in Constitutional Perspective: The Dark Side of Functional Differentiation* (Hart, 2011).

³² Gunther Teubner, ‘After Legal Instrumentalism: Strategic Models of Post-regulatory Law’ in Gunther Teubner (ed) *Dilemmas of Law in the Welfare State* (Walter de Gruyter, 1986) p.385; Gunther Teubner, ‘The Transformation of Law in the Welfare State’ in Gunther Teubner (ed) *Dilemmas of Law in the Welfare State* (Walter de Gruyter, 1986); Gunther Teubner, ‘Juridification: Concepts, Aspects, Limits, Solutions’ in Gunther Teubner (ed) *Juridification of Social Spheres: A Comparative Analysis in the Areas of Labor, Corporate, Antitrust, and Social Welfare Law* (De Gruyter, 1987) p.19ff.; Gunther Teubner, ‘Autopoiesis and Steering: How Politics Profits from the Normative Surplus of Capital’ in Roel J. in’t Veld and others (eds), *Autopoiesis*

concretely, a political system instrumentalises the law in order to control a specific social area and meet a specific political goal. However, such an intervention leads to over-legalisation of the social sphere.³³ As a result, political and legal systems ignore the autonomy of the sub-society. In relation to the regulatory failure,³⁴ a more fundamental problem is that the regulated sub-society does not react in a way that regulating systems such as the political and legal system expect, because each system operates autopoietically and indifferently from the others.³⁵ Therefore, clumsy intervention (non-regulation or heavy regulation) in the global economic system might cause unexpected repercussions, such as the sudden shrinkage of global investment or an economic downturn. In response to this unexpected reaction of sub-societies, the political system tends to respond with more direct and purposive measures by deconstructing legal formalities such as the rule of law or legal certainty (the over-socialisation of law).³⁶ Nevertheless, such measures turn out to be hopeless and ineffective because the regulated system reacts according to its own rationality, circumventing the political purposes of the legal system. For example, the imposition of a tax on corporations leads individual investors to avoid tax or escape to a tax haven. However, less tax does not necessarily mean greater national prosperity or the promotion of the national real economy as global private actors could invest in sectors not directly related to a nation's real economy, e.g. monetary finance.

However strong nation-states or other social systems are, this regulatory failure is unavoidable as long as regulatory techniques are based on the input-output model. A super nation-state (e.g. U.S.) or network of nation-states (G20) might be able to generate powerful binding regulations to control the global field to a certain temporary extent. However, its long-term effectiveness could not be secured without the voluntary cooperation of other GIR members. This is because no regulator can escape the dilemma of double contingency, in which the internal operations of two autopoietic systems remain blind to each other despite their mutual dependency. In fact, regulation itself could be conceptually understood as a flip side of observation in that the regulator cannot take action without observing the outputs of the regulated system. Here, the regulator is destined to suffer the risk of double contingency; the regulated system will have changed while the regulator was responding to observations. Even if the regulator happened to

and Configuration Theory: New Approaches to Societal Steering (Kluwer Academic Publishers, 1991); Teubner (n 17); Gunther Teubner, 'After Privatisation? The Many Autonomies of Private Law' (1998) 51(1) *Current Legal Problems*.

³³ Teubner 'After Legal Instrumentalism: Strategic Models of Post-regulatory Law' (n 32) p.387.

³⁴ Teubner 'Juridification: Concepts, Aspects, Limits, Solutions' (n 32) p.21.

³⁵ *ibid* pp.22-25.

³⁶ Teubner 'After Legal Instrumentalism: Strategic Models of Post-regulatory Law' (n 32) p.387. See also Teubner 'Juridification: Concepts, Aspects, Limits, Solutions' (n 32) p.25-27.

come up with an appropriate measure (M_1) to resolve the problem based on an initial observation of a certain situation (S_1) at a certain time (T_1), such a measure could too often become outdated in a changed situation (S_2) at another time (T_2). As a result, the previous measure (M_1) would often cease to work in the current situation (S_2). For instance, the government tends not to regulate the emerging high technology sector until relevant public concerns drive civil society to force the government to take action. However, technology in the regulated area changes so quickly that government regulations are soon outdated. In sum, the nation-state has trouble in taking pre-emptive and appropriate control over the continuously changing regulated system because as a regulator it can no longer have an omniscient vantage over the internal autopoietic logic of the regulated system.

C. Contextual control of the nation-state through global investment law

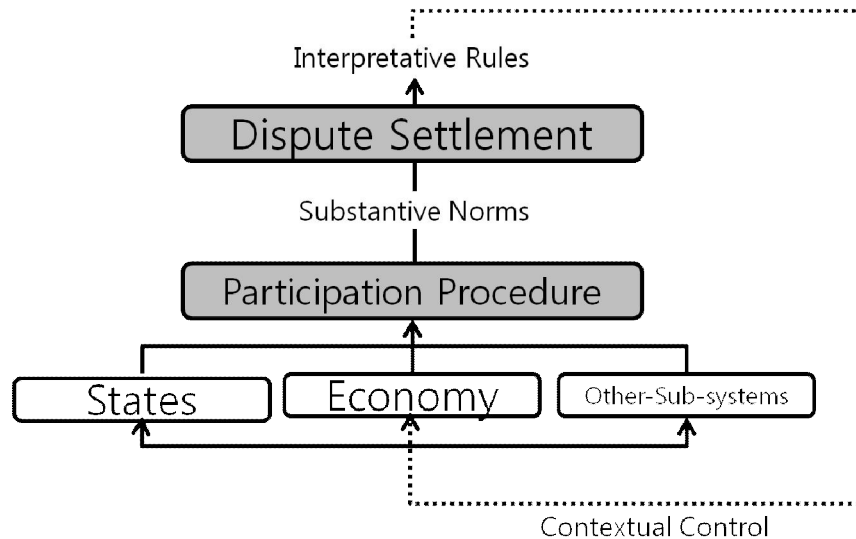
Today's nation-states suffer from a dilemma in relation to regulating the global investment field which operates beyond the cognitive capacity of the nation-state. Therefore, the clumsy national intervention of the outdated welfare-state model runs the risk of triggering an unpredictable backlash from the global investment field. At the same time, the recent global crisis caused by neo-liberalism teaches us a bitter lesson: global investment still needs regulation by the nation-state. The one-sided expansive thrust of economic power could ruin not only other sub-societies but also the economic system itself, culminating in the total collapse of world society.

Systems theory approaches propose judicious handling, namely contextual control, over the global regime by proceduralising structural couplings among the state, law and other regulated sub-societies.³⁷ The nation-state does not intervene directly and hastily in the social field even if it itself agrees that control is necessary. At the same time, to achieve a specific substantive goal, the nation-state indirectly manipulates the *context* within which global investment behaves.

In effecting contextual control, the nation-state could rely on the legal function of GIL in the GIR. In fact, the legal function of stabilising normative expectations through two elements (viz. participation mechanism and independent dispute settlement) of GIL can transform the mutual indifference of the regulatory trilemma into mutual credibility. Even if the negotiation of normative expectations does not perfectly satisfy all the demands of every GIR member, the legal system could help regime participants to reap the normative benefits of rough predictability over their

³⁷ Gunther Teubner, 'Substantive and Reflexive Elements in Modern Law' (1983) 17(2) *Law and Society Review* pp.266ff.; Teubner 'Juridification: Concepts, Aspects, Limits, Solutions' (n 32) p.27ff.

minimum interests. Such an expectation of predictability persuades GIR members to stay within the GIR itself. In turn, this persuasive authority based on stabilised normative expectations attracts regime participants more firmly over time. The effectiveness and enforcement of GIL comes not from formal top-down authority to bind the members of the GIR but from the practical persuasiveness of the legal function that creates mutual credibility (see Figure V-2).



<Figure V-2> Contextual Control Model

Nation-states can make regulatory power look acceptable to other global actors through contextual control. The nation-state can imbue the norm-making and interpretation of GIL with its own interests implicitly by using its formal power in two structural elements of GIL. Firstly, the participation process of GIL allows the nation-state, like other GIR members, to transplant its own interests into generally agreeable normative expectations. To take the example of indirect expropriation in the KORUS-FTA, Korea and the U.S. agreed to restrain their own regulatory power in order to attract foreign investment. At the same time, the Korean and U.S. governments were able to secure the minimum scope of regulatory power by introducing their own national doctrine of property rights. Secondly, once their national interests have been incorporated into the substantive norms of the investment legal system in the form of the treaty text, independent dispute settlement becomes obliged to consider the viewpoints of those states, in proportion to investment protection.

Through contextual control, the nation-state is able to secure the predictability of a minimum scope of controllability over the GIR. Of course, the contextual control model cannot

guarantee that a nation-state achieves a specific political goal, because the participation process is open not only to that state but also to other social actors and global investors. In addition, investor-state arbitration operates as an independent dispute settlement mechanism of GIL, without any connection to national influences. Once substantive norms have been established by the nation-states and other global actors, the nation-state cannot control the operation of the arbitration process, unlike state-to-state consultation. Therefore, the extent to which national interest can be secured against investment protection depends on the investment arbitrators reviewing a case, even if they are obliged to consider the arguments of both parties.³⁸ Nevertheless, this risk could be compensated for by the predictability of avoiding the worst-case scenario. To put it differently, the nation-state can maintain some control over the process by using GIL as a tool for contextual control without serious reputational damage. The proportionality principle of indirect expropriation provides a good example; in reality, many investment tribunals, which deal with longstanding doctrinal questions, propose a very balanced mode of reasoning between two colliding substantive interests, as opposed to a black-and-white mode of reasoning. Even where investment protection is respected, the nation-state does not lose all control over the global investment field in the sense that it prevents the worst-case scenario in which the regulatory power of the host state is ignored completely.

Given the functionally differentiated world society, the benefit of predictability could make contextual control convincing for the nation-state, which is required to control uncontrollable global social fields. Direct control by nation-states should overcome the too-costly challenges of the regulatory trilemma in the autonomous global investment field. Even if direct control looks politically attractive to the people, its effectiveness is uncertain because it suffers from unexpected backlashes from autonomous social fields. The nation-state is called upon to compare the risk of regulatory failure in exercising direct control and the risk of discouraging regulatory power in investment arbitration. One should consider whether the political support achieved through the application of direct control can be compensated for by the predictability of GIL. If this cost-benefit analysis is considered from the side of the nation-state, contextual control might be more workable than direct control in promising a rough predictability. Of course, GIL cannot perfectly ensure that nation-states will achieve their intended goals. Indeed, the original expectations of the nation-state could always be refracted by the rationalities of other actors in the course of their strategic

³⁸ The nation-state under current GIL is allowed to influence an investment tribunal in treaty interpretation in a certain way. Nevertheless, it is worth noting that the measures for involvement in a tribunal's interpretation should not and could not impair the essential function of investment arbitration, which is ultimately the autonomy of GIL because those measures are fundamentally supplementary and indirect. See Chapter V. Part IV.D.iii).

compromises with these actors. Further, there remains a risk that the independent dispute settlement regime could curb state policy goals in managing foreign investment. However, contextual control can prevent actors from monopolising the global regime through their own one-sided rationalities. Conversely, this measure can guarantee that no actor, especially the state, will lose their entire capacity to control the regime. As can be inferred from the regime theory, this approach allows the nation-state to secure the second worst or the second best outcome by giving up uncertain direct interventions to achieve the ideal goal.

D. Dynamic autonomy of global investment law through structural coupling

This does not mean that the nation-state is useless in contextual control. Indeed, the nation-state has a formidable formal power to shape the global mechanism through treaty-making. Given this, systems theory suggests that each nation-state could use its formal power more efficiently by establishing a form of structural coupling between the law and the global economy within the GIR. To be specific, most of the structural elements of GIL, such as treaties, are established only through the formal powers of nation-states. Therefore, the nation-state pays more attention to the proceduralisation of the legal system than manipulating substantive content.³⁹ In this sense, contextual control requires nation-states to use their own powers in a wiser way.⁴⁰

The nation-state needs to secure the autonomy of the legal system in order to make contextual control effective. Contextual control works effectively when the GIR and GIL are operational. If the legal system were dominated by the rationality of one sub-society, it would become unattractive to the actors of other sub-societies. Such other actors might withdraw their compliance with the regime if they cannot expect the legal system to guarantee their minimum interests and prevent the worst-case scenario. In this context, Teubner argues that the law can be autonomous when it follows an independent evolutionary path by changing its own internal structure in a self-referential way even if it responds to external influences.⁴¹ The law can gradually achieve a closed and autopoietic operation when (and more importantly because) the legal system is

³⁹ Teubner (1983) (n 37) p.270.

⁴⁰ Teubner (1991) (n 32).

⁴¹ Gunther Teubner, 'Evolution of Autopoietic Law' in Gunther Teubner (ed) *Autopoietic Law: A New Approach to Law and Society* (Walter de Gruyter, 1988) pp.231-37; Gunther Teubner, *Law as an Autopoietic System* (Blackwell Publishers, 1993) pp.47-63.

cognitively open to the various sub-societies.⁴² In this context, the autonomy of a system does not necessarily mean that the system is hermetic or insular towards substantive content.

In explaining the openness and closure of one system toward other system, the concept of structural coupling plays a significant role in making the legal system functional by setting up its autonomy from other external influences. Systems theorists explain that structural coupling, in which one system is structurally related to the other or to the environment,⁴³ occurs when 'a system presupposes certain features of its environment on an ongoing basis and relies on them'.⁴⁴ Even if structural coupling allows for the interference of one system to trigger changes in the other system, this interference is not direct; it is only reflexive with regard to input and output.⁴⁵ Structural coupling establishes only the structural conditions in which two systems can influence each other. One cannot determine how those systems will react to each other due to several systems theory premises. Firstly, the two systems operate according to different rationalities and speeds, just like two people speaking different languages. More precisely, each system communicates with a different code and programme; whereas the legal system understands things according to a legal binary code (legal/illegal), the economic system understands them on the basis of possession/non-possession. Secondly, structural coupling can secure the occurrence of a response as one system can recognise the operations of the other system as perturbations (*Irritationen*, *Überraschungen*, or *Störung* in German)⁴⁶ The perturbation, as an internally constructed surprise, irritation, disappointment or disturbance, occurs cognitively within the system which realises that external events are happening contrary to its expectations;⁴⁷ it is like a shop assistant who feels embarrassed when a shopper comes in and speaks in a foreign language. Here, the shop assistant processes this embarrassment in his or her own language based on his or her own expectations. Likewise, a system processes those perturbations in a self-referential way, so that one system cannot anticipate when and how the other system will react. Of course, an autopoietic system has an absolute logical discretion to turn its face away from perturbations because it basically operates self-referentially. However, it gradually becomes impossible for the system not to react to perturbations because the

⁴² Guther Teubner, 'De collisione discursuum: Communicative Rationalities in Law, Morality and Politics' (1996) 17(4-5) Cardozo Law Review; Teubner (n 1).

⁴³ Georg Kneer and Armin Nassehi, *Niklas Luhmanns Theorie sozialer Systeme: eine Einführung* (W. Fink, 2000) pp.62-63; Niklas Luhmann, *Law as a Social System* (Oxford University Press, 2004) pp.381-85. See generally Claudio Baraldi, Giancarlo Corsi and Elena Esposito, *GLU: Glossar zu Niklas Luhmanns Theorie sozialer Systeme* (Suhrkamp, 1997) pp.186-89.

⁴⁴ Luhmann (n 43) p.382.

⁴⁵ *ibid* pp.382-83.

⁴⁶ Niklas Luhmann, 'Operational Closure and Structural Coupling: The Differentiation of the Legal System' (1992) 13(5) Cardozo Law Review. pp.1432-33; Luhmann (n 43) p.383.

⁴⁷ Luhmann (n 43) pp.382-83.

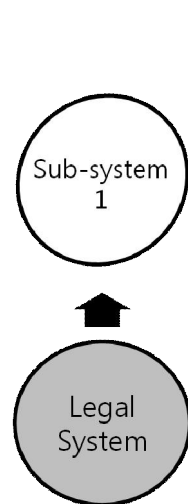
increasing complexity of society generates more chances of external challenges against the systems. Figuratively speaking, although the shop assistant could refuse to trade with foreigners once or twice, it is impossible to do so in a shop in a tourist attraction which hundreds of foreigners visit every day. To summarise, two autopoietic systems operating indifferently are gradually coupled with the other system in the course of structuralising the process in which one system perceives impacts from the other and reacts to them in a self-referential way.⁴⁸

The openness of the legal system can serve as a precondition for dynamic legal autonomy among competing social values by making simultaneous and equal structural couplings with sub-systems. The legal system as a partially autopoietic system is partially autonomous from one system (and its actor) such as a political system (and the nation-state) or the economic system (and multinational company) (see Figure V-3). However, functional differentiation does not allow the legal system to make a structural coupling with either society as a whole or only one sub-society. Instead, the law establishes many individual structural couplings with numerous sub-societies which emulate one another. Each of these sub-societies attempts to instrumentalise (or colonise) the law under their sub-societal rationalities in order to expand those rationalities into other societies – and ultimately into society as a whole. Thus, the power game played among competing sub-social systems ends with an ironic situation in which the colliding social influences of sub-societies put the law into a situation in which those sub-societies come into balance with each other. Figuratively speaking, the law can be impartial due to this armistice among the sub-societies. At this point, the autonomy of the law might be able to develop an autonomous rule of conflicts to cope with the dynamics of social sub-systems at the periphery of the law. Here, the autonomy of the legal system fluctuates among external social influences; even if the legal system would be temporally dominated by one system, this inclination is later balanced by another counter-movement (see Figure V-4).⁴⁹

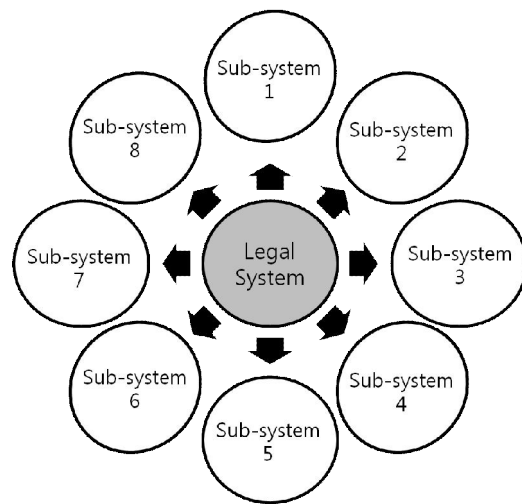
⁴⁸ The concept of structural coupling is too abstract and complicated to summarise in just a few paragraphs. An appropriate understanding of structural coupling is one of the most controversial issues in the scholarship of systems theory. In a sense, it looks as if this concept provides systems theorists with a good excuse to avoid meaningful criticism, because they can abuse the concept of structural coupling as a panacea whenever they observe evidence that threatens the theoretical proposition for the autopoietic closure of a system. Abuse of the concept of the structural coupling could relax the rigorous understanding of autopoiesis. Despite the risks of misunderstanding, it seems obvious that this concept could serve as a fecund source for plausible solutions to deal with the dark side of functional differentiation, which is the cause of mutual indifference between systems. At least, the benefits of emphasis on structural coupling seem to outweigh the risks of misunderstanding autopoiesis in Teubner's view that the autopoiesis can be relativised and evolutionary.

⁴⁹ Gunther Teubner, 'Justice under Global Capitalism?' (2008) 19(3) *Law and Critique*.

This structural mechanism transforms bare social conflicts into conflicts within legal arguments representing the rationalities of individual sub-societies.⁵⁰ Moreover, the vigorous tensional debates between colliding rights or doctrines leave the conflicts to a specific and impartial institutional mechanism to produce an autonomous rule in terms of its self-constitution.⁵¹ In addition, global justice emerges not as a specific substantive value, but as a polytextually relational value in the course of adjusting colliding rationalities in a polycentric world.⁵²



<Figure V-3>



<Figure V-4>

III. CONSTITUTIONALISM FOR STRUCTURAL COUPLING IN THE GLOBAL INVESTMENT REGIME

A. Analogical application of constitutionalism to the global investment regime

The most important point for successful contextual control is how the nation-state contributes to legal autonomy. If the legal system is dominated by the rationality of one sub-society, the GIR will be trapped in an abyss of double contingency which would cause a vicious circle of mutual distrust. Nonetheless, the evolution of GIL has recently entered by a narrow margin into the

⁵⁰ Zumbansen (n 6) p. 795.

⁵¹ Teubner and Fischer-Lescano (n 1) pp. 1045-46.

⁵² Teubner (1996) (n 42) pp. 910-11.

phase of a partially autopoietic legal system. GIL as a global law is fundamentally exposed to the dynamic power games of unequal global actors, on the one hand, and is still in an early stage of producing a consistent jurisprudence against challengeable political or economic thrusts, on the other. Strictly speaking, the future of GIL is still up in the air and it depends ultimately on how to establish legal autonomy through a balanced and simultaneous structural coupling between GIL and various social influences.

Given this, a system theoretic understanding of the constitution could provide valuable suggestions for establishing a structural coupling between GIL and other social sectors. Of course, it is unclear whether Teubner's global societal constitution might be observable in the current global field in the light of the traditional understanding of the constitution; the traditional concept of the constitution presumes that the constitution is usually produced in close connection with a political entity such as the nation-state. In particular, it looks quite doubtful whether one could find a global investment constitution in the GIL without the existence of a world government. However, one could find several faint but promising features of such a constitution as long as the constitution is understood not just as a legal text but as a structural coupling between GIL and other social sectors. Finally, one could assess how firmly GIL is established for legal autonomy by examining the constitutional features in the global investment field. Additionally, nation-states can promote those constitutional features in order to set up a more firmly established structural coupling. In this context, the following sections will examine the constitutional features of the global investment field.

Teubner proposes a *global societal constitution* which would reflect the direct structural coupling between the law and sub-societies without the nation-state.⁵³ Initially, Luhmann argued that the constitution presents a structural coupling between the law and (national) politics, where it secures the autopoiesis of law from the interplay with politics and vice versa.⁵⁴ Luhmann's understanding of the constitution mainly remained at the national level before the heyday of globalization. Teubner applies this concept to a global perspective in the name of a global societal constitution.⁵⁵ The global societal constitutions in the differentiated sub-social systems 'are neither

⁵³ Gunther Teubner, 'Global Private Regimes: Neo-Spontaneous Law and Dual Constitution of Autonomous Sectors?' in Karl-Heinz Ladeur (ed) *Public Governance in the Age of Globalization* (Ashgate, 2004) p.74.

⁵⁴ Luhmann (n 43) pp.381-422.

⁵⁵ Teubner (n 53) p.74.

legal texts nor are they the de facto structures of social systems'.⁵⁶ A societal constitution occurs through the long-term stabilisation of the dynamic relationship between legal and social autonomy.⁵⁷ The fundamental structure of this relationship is similar to the relationship between the law and the political system in the state constitution. In fact, Luhmann argues that while the political constitution appears to be associated with the production of legal norms from the legal perspective, it is considered to structuralise the political system from the political perspective.⁵⁸ This mechanism could also be found in the global societal constitution; the legal system considers the societal constitution to be the production of legal norms which are relevant to the structure of the social system. At the same time, the societal constitution structuralises the social system which is coupled by allowing the law to perceive the rationality of the social system.⁵⁹

This structural coupling sets the conditions which enable mutual perturbations to occur between the structurally-coupled autopoietic systems. To take the example of the political constitution, the author of the constitution intends to prescribe the constitutional text using abstract and vague language which could be acceptable to both the political and the legal systems. The shared but intentionally ambiguous meanings inscribed in the constitutional text serve as a resource that one system could rely on in the case of perturbations.⁶⁰ For example, suppose the constitution prescribes the term 'democracy' in the constitutional text without giving any detailed substantive contents. In relation to this legal text, the relevant actors can influence each other through a series of constitutional procedures prescribed in the constitution. The political system can influence the legal system through procedures of norm-making in accordance with the political understanding of democracy. By the same token, the legal system can attempt to control the political structure through the judicial system in order to take charge of the legal interpretation of the idea of democracy. In this context, the constitution is a holistic concept which includes a legal text, together with institutions and procedures to deal with influences or perturbations between the two social systems.

In comparison with the national constitution, the global societal constitution provides the conditions for structural couplings based on a similar logic but in a different context. As can be seen in the regulation of the internet, many global norm-making processes seem to be faced with two

⁵⁶ Gunther Teubner, 'Societal Constitutionalism: Alternatives to State-Centred Constitutional Theory' in Christian Joerges, Inger-Johanne Sand and G Teubner (eds), *Transnational Governance and Constitutionalism: International Studies in the Theory of Private Law* (Hart Publishing, 2004) p.20.

⁵⁷ *ibid.*

⁵⁸ Luhmann (n 43) pp.403-19.

⁵⁹ Teubner (n 56) p.20.

⁶⁰ Luhmann (n 43) pp.410-11.

kinds of problem; it is nearly impossible for an authority acting nationally to regulate global issues beyond its national borders, and, at the same time, inter-governmental consensus, including international treaties, needs to overcome a number of political obstacles.⁶¹ The same applies to GIL. As illustrated by the failure to establish a Multilateral Agreement on Investment (hereafter ‘MAI’), the global investment field faces many political challenges from nation-states or other social actors which still have significant influence, despite their limited powers.⁶² Therefore, the global investment sector has not established the unitary or centralised constitution possessed by the nation-state.

Instead, the GIR has gradually established meta-level self-regulation arising from the rough consensus achieved through its hybrid dynamic of norm-making. To be specific, the communicative networking in the global regime (community) produces a ‘running code’ based on a ‘rough consensus’.⁶³ In fact, the global community, unlike the nation-state, cannot generate strong and formal legitimacy.⁶⁴ Therefore, the process of norm-creation starts from a *pilot* phase – where the norm would not have a strong binding effect – as seen in model laws, recommendations or reports.⁶⁵ This proto-code is not fixed but is open to ongoing revision as it is circulated in communicative networking.⁶⁶ For example, the revision process is open to academic discussion, to governmental process by trade policy makers or to the global participation of civic groups. Continuous communication within an issue-driven regime *experiments on and updates* the proto-code into a more hardened norm. In the history of GIL, the primitive principles of international investment rules were systemically shaped as a prototype of GIL by a group of academics and businessmen in the 1959 Abs-Shawcross Draft Convention on Investment Abroad. Those pioneers imported many important principles such as expropriation from traditional international law. Even if those principles and substantive norms were not so popular at that time, they were continuously updated or re-discussed by policy makers, lawyers or scholars. In particular, the model investment treaties of major investment-exporting countries have a significant role in establishing a set of

⁶¹ Teubner (n 56) pp.20-21.

⁶² The OECD members had negotiated this agreement to establish a uniform and systematic rule to deal with the global investment issues. Some pointed out that these negotiations were going on without enough participation of the non-OECD countries and civil society. Finally, this deal broke down, as it faced massive criticism from civil society and from the developing countries. See Peter T. Muchlinski, ‘The Rise and Fall of the Multilateral Agreement on Investment: Where Now?’ (2000) 34(3) International Lawyer.

⁶³ Galf-Peter Calliess and Peer Zumbansen, *Rough Consensus and Running Code: A Theory of Transnational Private Law* (Hart, 2010) p.134ff.

⁶⁴ David Held, *Democracy and the Global Order: From the Modern State to Cosmopolitan Governance* (Polity Press, 1995) pp.16-18.

⁶⁵ Calliess and Zumbansen (n 63) p.135ff.

⁶⁶ *ibid* p.140ff.

investment legal principles that many GIR members share. To be specific, many negotiations of international investment treaties tend to update the model BITs of major economic powers such as the U.S. or U.K. For example, the U.S. FTAs with Korea, Panama and Columbia employ similar language because they were negotiated individually by making changes to the U.S. Model BIT. The model BITs will also be updated in the future and discussed in academia, in policy making processes and in civil society.

Even if the GIR does not have any classic form of constitution, it seems to perform a similar function to a traditional constitution in light of structural coupling. Although such internal systems of the GIR are pluralised and embryonic, compared to national constitutions, they have structurally coupled GIL and other sub-societies, as will be seen in the following sections.

B. Rule-making through judicial review in global investment law

One of the most important tasks of the constitution in structural coupling is to deal with structural corruption that has the potential to destroy legal and social autonomy.⁶⁷ The history of the state political constitution shows that political authoritarianism has easily encroached upon legal autonomy and vice versa because mutual perturbations between the law and politics are too fragile to maintain a balance. Therefore, the modern political constitution has tackled stable institutionalisation of the dynamic equilibrium in which the two opposite influences of the political system and the legal system occur at the same rate.⁶⁸ For example, economic demands attempt to liberalise capital flows by deconstructing constitutional social rights, whereas political rhetoric in favour of the social welfare state bends various constitutional principles of civil liberty. Here, the constitution devotes itself to maintaining a dynamic balance where one influence could be offset by another one. This fundamental issue of the political constitution is also applicable to the global sphere because global law-making is vulnerable to the pressure of the rationality of coupled sub-societies.⁶⁹ In response to this structural corruption, the constitution draws a distinction between illegal corruption and legitimate perturbation by institutionalizing this perturbation mechanism.⁷⁰

Therefore, the constitution transforms the distinction between a legal and an illegal perturbation into the distinction between a constitutional and an unconstitutional perturbation, according to a hierarchical distinction between an ordinary and a higher rule. In this context, the

⁶⁷ Teubner (n 53) pp.85-86.

⁶⁸ Luhmann (n 43) pp.383-84.

⁶⁹ Teubner (n 56) pp.21-22.

⁷⁰ *ibid.*

constitution recognises the higher rule as a constitutional law against ordinary law. As noted above, the legal system stabilises normative expectations by holding, as illegal, external influences that threaten originally agreed expectations. Here, the legal system is situated in a dilemma of cognitive infinite regression. In other words, how could the law validate a rule to validate the law? How can there be a legality of legality?⁷¹ This inherent paradox of the legal system requires another paradoxical rule: the constitution, which can declare the illegality of legally-enacted law by using the term, ‘unconstitutionality’. Simultaneously, the constitution can contain the rules and procedures that produce and verify itself.⁷² Here, Hart’s articulation of the relationship between a secondary rule and a primary rule could provide fecund suggestions to alleviate this legal paradox. Of course, the recognition of a secondary rule might not eliminate the legal paradox because the legality of the secondary rule remains as an unresolved issue in this circular logic. Therefore, the legal system is again stuck with an infinite cognitive regression, as it does not answer the question of how to recognise the secondary rule to recognise the primary rule (the secondary-secondary rule?).⁷³ Historically speaking, constitutional theorists have suffered from this paradox, despite numerous efforts to identify ‘separate self-production rules’.⁷⁴ This issue continues in a more serious way in the context of globalisation without a formal, positive norm-making process.⁷⁵ This constitutional issue in the global context broaches a number of questions, such as who the norm-author is or what procedure could be employed for the recognition or production of the secondary norm.⁷⁶

The constitution has traditionally attempted to deal with this paradox by establishing the hierarchical order of the judicial system. To take the example of the political constitution, a systems theoretic understanding of the constitution does not encompass only the constitutional texts but also the interpretative rules of the texts as well as the structures that produce the rules, norms and other relevant institutions. The most important part of the constitution is the institution which produces a higher law as a secondary rule; this is usually taken to be the process of judicial review. For instance, the supreme or constitutional court, in the political constitution, will hold a legally enacted law to be unconstitutional if there is a substantive contradiction with constitutional law.⁷⁷ For

⁷¹ Teubner (1993) (n 41) pp.3-4.

⁷² Luhmann (n 43) pp.406-08.

⁷³ Teubner (1993) (n 41) pp.39-40.

⁷⁴ Teubner (n 56) p.23.

⁷⁵ *ibid.*

⁷⁶ *ibid.*

⁷⁷ *ibid* p.24.

instance, *Marbury v. Madison*⁷⁸ paved the way for constitutional review which made a distinction between constitutional and ordinary legal jurisdiction.⁷⁹ Here, even if the judicial body relies on the constitutional text, it produces its own doctrine in the form of a constitutional review which chooses among various colliding interpretations of the same constitutional text. To put this into system theoretic language, the rule of legal interpretation could be condensed through the system of forgetting and remembering, in which the judicial body has a decisive role in this rule-making process. In light of Teubner's concept of self-constitution, one could call a decision of this kind a 'constitutional review', given that the constitution applies its own rule to the case against social expectations. In this autopoietic networking of courts, self-constitution translates this recognition of social rationality into a legal language in accordance with the general legal principle which presents legal rationality.⁸⁰ Through the selective adaptation of the legal system to other social systems, the global societal constitution could establish a structural coupling in a stable way to prevent illegal corruption and stabilise legitimate perturbation.⁸¹

The global regime similarly establishes 'a de facto constitutional review of non-legislative law' at multiple levels such as domestic or international, or private or public.⁸² However, there is no hierarchical structure in the global sphere that is comparable to the traditional political constitution. In other words, there is no higher court in the global sphere because the global regime does not have a clear jurisdictional differentiation among diversified legal tribunals. To take an example from GIL, GIL does not have any formal higher court to review individual arbitrations because the tribunals in the individual arbitrations are not formally obliged to follow other arbitration decisions. Instead, they are influenced only by the reputational hierarchy of some big institutions, such as ICSID.

In terms of systems theory, the establishment of a higher judicial body serves as a minimum condition for the firmly established structural coupling of GIL. In other words, GIL would not last long without the institutional process which reviews previous decisions. In fact, GIL suffers from inconsistency in its jurisprudence because the pluralised setting of the judicial system allows individual tribunals to enjoy quite broad discretion. For example, *Lauder v. Czech Republic*⁸³ and

⁷⁸ *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803).

⁷⁹ Teubner (n 56) p.24.

⁸⁰ *ibid* pp.24-25.

⁸¹ *ibid* p.25.

⁸² *ibid* p.24.

⁸³ *Lauder v. Czech Republic*, UNCITRAL (United States/Czech Republic BIT), Award, 3 September 2001.

*CME v. Czech Republic*⁸⁴ were decided differently, despite their shared facts or arguments.⁸⁵ As long as the original expectations are too changeable, the system might become less attractive to GIR members due to its arbitrariness. In this situation, an appellate mechanism can increase the coherence and consistency of GIL⁸⁶

It is still controversial among international investment lawyers whether the establishment of a higher investment court is necessary, or even possible.⁸⁷ One practitioner points out that the pluralised nature of GIL makes it difficult to secure a water-tight level of consistency and coherence.⁸⁸ However, it might look reasonable that GIL requires rough consistency to persuade GIR members to stay within the regime. In this sense, the current reputation-driven mechanism is not sufficient to secure rough consistency and coherence. An influential decision from previous arbitration does not completely prevent the reasoning overruled by that institution from being revived in other future arbitrations because each arbitration decision does not have any formal precedential value for future arbitrations.⁸⁹

C. Internal differentiation between the organised and the spontaneous sector

GIL suffers from a classical legitimacy problem in its norm-creation. In response to this legitimacy problem, systems theorists have reconstructed Held's cosmopolitan democracy within

⁸⁴ *CME v. Czech Republic*, UNCITRAL (Netherlands/Czech Republic BIT), Partial Award, 13 September 2001.

⁸⁵ Christian Tams, 'Is There a Need for an ICSID Appellate Structure' in Rainer Hofmann and Christian Tams (eds), *The International Convention for the Settlement of Investment Disputes: Taking Stock After 40 Years* (Nomos, 2007) pp.232-34 (analysing other instances to show the inconsistency in international investment law).

⁸⁶ Susan D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2005) 73(4) *Fordham Law Review* pp.1617-25; Karl P. Sauvant, 'The Rise of International Investment, Investment Agreements and Investment Disputes' in Karl P. Sauvant (ed) *Appeals Mechanism in International Investment Disputes* (Oxford University Press, 2008) p.15; ICSID, 'Possible Improvements of the Framework for ICISD Arbitration ICSID Secretariat Discussion Paper' (22 October 2004) pp.14-15 <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnouncePDF&AnnouncementType=archive&AnnounceNo=14_1.pdf> accessed 15 April 2012.

⁸⁷ Tams (n 85) pp.231-40; Asif H Qureshi, 'An Appellate System in International Investment Arbitration?' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) pp.1157-59; Federico Ortino, Audley Sheppard and Hugo Warner (eds), *Investment Treaty Law: Current Issues Volume 1* (British Institute of International and Comparative Law, 2006), pp.113-148.

⁸⁸ *ibid* pp.234-35; Barton Legum, 'Options to Establish an Appellate Mechanism for Investment Dispute' in Karl P. Sauvant (ed) *Appeals Mechanism in International Investment Disputes* (Oxford University Press, 2008) pp.237-38.

⁸⁹ This issue is discussed in Chapter V. Part IV. B. iv).

the issue-driven (functionally differentiated) regime beyond a territorially delineated state.⁹⁰ In fact, the general notion of democracy in the 19th and 20th centuries assumes that the legitimacy of state-law is established through a 'symmetrical' and 'congruent' relationship between the decision-maker (government) and the decision-taker (people).⁹¹ Here, a formal majority voting system in the national constitutional setting secures this mechanism of legitimacy production. However, the context of a highly atomised international organisation and non-state actors challenge this constitutional link between the rule-making authority and the affected people by setting aside the state.⁹² This situation appears to be as if a handful of experts were to decide the creation and application of norms which affect a number of lay people.⁹³ In response to this challenge, Held and the proponents of his theory propose the possibility of democracy in the transnational sphere.⁹⁴ To be more exact, the boundary of this transnational community and the identity of its members are defined according to the extent of *affectedness*⁹⁵ beyond a territory-based politics, just as the regime is formed by specific issues. Therefore, any person or actor is assumed to have a tentative entitlement to participate in the communicative network of norm-making as long as those global players are affected by the relevant communicative system. The boundary and identity of the global regime can be tentatively decided by the degree of affectedness of the involved persons' everyday lives by the global issues.

Such analyses bear an interesting resemblance to the differentiation of organised and spontaneous sectors, which originate from the model of the state-constitution. Initially, this internal differentiation into 'a spontaneous and a formally organized sphere'⁹⁶ has been successful in the political constitution.⁹⁷ Habermas has described a relationship between the political centre and political periphery in the public sphere.⁹⁸ He explains that the conflicts occurring in the periphery

⁹⁰ Calliess and Zumbansen (n 63) pp.130-32.

⁹¹ Held (n 64) p.16.

⁹² A. Claire Cutler, 'Critical Reflections on the Westphalian Assumptions of International Law and Organization: A Crisis of Legitimacy' (2001) 27(2) *Review of International Studies*.

⁹³ Calliess and Zumbansen (n 63) pp.124-26.

⁹⁴ See generally David Held, 'The Changing Contours of Political Community: Rethinking Democracy in the Context of Globalization' in Barry Holden (ed) *Global Democracy: Key Debates* (Routledge, 2000); David Held, 'Democratic Accountability and Political Effectiveness from a Cosmopolitan Perspective' (2004) 39(2) *Government and Opposition*; David Held and Anthony G. McGrew, 'Reframing Global Governance: Apocalypse Soon or Reform!' in David Held and Anthony G. McGrew (eds), *Globalization Theory: Approaches and Controversies* (Polity Press, 2007).

⁹⁵ Calliess and Zumbansen (n 63) p.130.

⁹⁶ Teubner (n 53) p.84.

⁹⁷ *ibid* p.85.

⁹⁸ Jürgen Habermas, *The Structural Transformation of the Public Sphere: An Inquiry into a Category of Bourgeois Society* (Polity Press, 1989) (describing the public sphere). See also Jürgen Habermas, *Between*

transfer into the political centre. Specifically, the public opinion initiated in the political periphery pushes the political centre to recognise and solve the conflicts in a collectively binding and formal fashion without apparent violence. Such processes are described and operated with use of legal terms (e.g. rights, claims, or legislation).⁹⁹ In a similar way, Teubner argues that the political constitution represents the dualism of ‘the government’ and ‘public opinion’,¹⁰⁰ which in turn presents a correlation between ‘the organisational law of the state and the citizen’s fundamental rights’.¹⁰¹ The political parties and the state administration in the formally organized sector produce the legal norm and implement the law, whereas they are coupled with the spontaneous sector where electorates or interest groups participate in the norm-making. As a result, the political constitution has developed the institutions required to permit citizen involvement in norm-making; for example, the citizen could have an active role in legislation and the implementation of law through the mechanism of representation. Moreover, legal (constitutional) rights in the court system allow people to take a passive role in the law-making of the organised sector through legal claims against those laws. This internal differentiation promotes creative perturbation and filters out structural corruption by preventing unjustified political pressure from destroying legal autonomy, and the converse is also true.¹⁰² In globalisation, the dual structure managed by the traditional constitution is replaced with ‘the relationship between the spontaneous sector of international relations and of international organisations under other auspices’.¹⁰³

The separation between the legal centre and periphery serves an important role in establishing a structural coupling. In fact, the social norms produced on the legal periphery are applied by the legal centre where the judicial bodies are located. Here, the court located in the legal centre could be strictly bound by the legal text as a set of normative expectations, whereas that legal text itself is produced through participation by the relevant actors on the legal periphery. The legal centre does not accept other social influences in a direct way but in an indirect way by considering the legal texts that are produced by the social actors of the legal periphery. In other words, the legal centre (judicial body or tribunal) could be reflexive to other external influences not through the direct acceptance of social interests but through an indirect filtering of the legal periphery which

Facts and Norms: Contributions to a Discourse Theory of Law and Democracy (Polity Press, 1996) pp.354-358 (differentiating between the political periphery and centre within the public sphere).

⁹⁹ Habermas (1996) (n 98) pp.359-387.

¹⁰⁰ Teubner (n 53) pp.85-86.

¹⁰¹ Teubner (n 56) p.27.

¹⁰² Teubner (n 53) pp.85-86.

¹⁰³ Teubner (n 56) pp.27-28. See also Teubner (n 53) p.84.

facilitates the structural mechanism that transforms bare social interests into legal languages.¹⁰⁴ As a result, the reflexivity or multiplicity of the legal centre does not depend on how open the legal centre itself is, but on how open the participation procedures of norm-making in the legal periphery are to the other social interests. Under the legal centre/periphery distinction, the legal system could secure autonomy and reflexivity at the same time through structural coupling with other sub-societies.

Finally, the challenging task of global law is to promote this dualism, especially by supporting the spontaneous sector and stabilising the justifiable stable perturbation between the two sectors. In fact, Teubner admits that this internal differentiation in the global sphere is very weak in comparison to that of the political constitution (government/people) or the economic constitution (enterprises/market).¹⁰⁵ He analyses the fact that non-political and non-economic sub-societies do not make sufficient distinction between organised rationality and its corresponding spontaneity,¹⁰⁶ even if he recognises some promising autonomies of the sub-societies in the recent globalisation, this autonomy is still very vulnerable to re-colonisation by more strongly established political and economic rationality. A more serious problem is that the atomisation of sub-societies leads to the establishment of ‘a formally organized sphere of bureaucratic decisions’.¹⁰⁷ Nonetheless, Teubner attempts to look at the promising but incipient evidence of an emerging spontaneous sector in various sub-societies.¹⁰⁸ Here, issues of democracy such as participation that Held has raised at the level of global politics are revived as urgent issues at the level of fragmented global sub-societies in order to establish ‘an autonomous regime of organised decision and spontaneous control process’.¹⁰⁹ In particular, the global law project makes sure that this social control is managed not by political or economic thrust but by multiplexity.¹¹⁰

As with the dualism of the constitution, the global investment field can be differentiated into a centre and a periphery, or into an organised and a spontaneous sector. In terms of a rough consensus and a running code, a rough consensus formed in the spontaneous sector (the periphery)

¹⁰⁴ Luhmann (n 43) p.292ff.

¹⁰⁵ Teubner (n 53) p.85 (explaining the dualism of the economy).

¹⁰⁶ *ibid.*

¹⁰⁷ *ibid* pp.85-86.

¹⁰⁸ *ibid* pp.68-87; Teubner (n 56) pp.27-28.

¹⁰⁹ Teubner (n 53) p.86.

¹¹⁰ *ibid* pp.86-87. See also Teubner (1998) (n 32); Gunther Teubner, ‘State Policies in Private Law? Comment on Hanoch Dogan’ (2008) 56(3) *The American Journal of Comparative Law*; Gunther Teubner, ‘Constitutionalising Polycontextuality’ (2010) <http://www.jura.uni-frankfurt.de/1_Personal/em_profs/teubner/dokumente/ConstitutionalisingPolycontextuality_eng.pdf> accessed 15 April 2012.

of global investment is evolved into a running code of the organised sector (the centre). On the one hand, these are matched with the elements of GIL; the participation process allows regime actors in the spontaneous sector to produce a rough consensus regarding investment protections and restrictions. As the spontaneous sectors are influenced by social interests, actors (the host states, global investors and civil activists) attempt to transplant their own social interests into the substantive normative contents. On the other hand, the centre of GIL is the network of investment arbitrations that can produce an interpretative rule by applying norms to specific cases.

Through the constitutional mechanism, the centre and periphery, namely the independent dispute settlement system and the participation mechanism of the investment legal system, are checking each other. This dynamic of mutual checks and balances is similar to a tensional relationship between the legislature (or people) and the constitutional court. As the constitutional court reviews legislative or governmental acts, the investment tribunal also reviews the acts of host states and investors. Meanwhile, other sub-societies could indirectly control the tribunal by influencing the treaty text which could bind the tribunal to apply the law in a certain way. Therefore, the substantive interests of other legal systems are incorporated into the languages of the investment normative text. To take an example from the indirect expropriation issue, the tribunal is required to consider regulatory power and other public interests because the government and civil society have incorporated 'legitimate public welfare objectives' into the treaty text.¹¹¹

Nevertheless, the spontaneous sector of the current global investment field is not reflexive enough to various social contexts due to a lack of participation. In fact, current GIL is too vulnerable to economic influences or investment-importing countries, whereas it is blind to other social values such as human rights. Even if some civil society groups have proposed an alternative model BIT which attempts to secure various social interests, this has not been broadly accepted by national policy makers.¹¹² To take the example of NAFTA negotiations, the power imbalance between the U.S. and Mexico has prevented NAFTA from incorporating the Mexican national legal system.¹¹³ In the case of the KORUS-FTA, some critics argue that the expropriation clauses are too oriented to the U.S. property doctrine, despite the adoption of several Korean property

¹¹¹ Free Trade Agreement between the Republic of Korea and the United States of America (KORUS-FTA) Annex 11-B.3(b)

¹¹² e.g. Howard Mann and others, *IISD Model International Agreement on Investment for Sustainable Development* (International Institute for Sustainable Development, 2006) <<http://www.iisd.org/publications/pub.aspx?pno=686>> accessed 15 April 2012.

¹¹³ Stephen Zamora, 'The Americanization of Mexican Law: Non-Trade Issues in the North American Free Trade Agreement' (1993) 24(2) *Law and Policy in International Business*.

doctrines.¹¹⁴ In addition, the participation process at the national level is not sufficiently open to other social interests, even though the treaty is closely associated with the everyday life of ordinary people.¹¹⁵

IV. KOREAN CONSTITUTIONAL ALTERNATIVES FOR STRUCTURAL COUPLING OF GLOBAL CONSTITUTIONALISM

The previous parts have argued that the nation-state can secure contextual control over the global investment field by relying on the autonomy of GIL. In order to achieve contextual control, GIL is required to establish a structural coupling between the legal system and other sub-societies in the light of global constitutionalism. Despite some evidence of the global constitution, current GIL does not perfectly meet the conditions of the global constitution. In this context, the nation-state could have one of the most important roles in promoting the constitutional features of GIL as long as the nation-state defines itself as one of the GIR participants. Although the nation-state can no longer entirely dominate the GIR, the formal powers of nation-states cannot be ignored, especially in terms of treaty making. In this context, the following sections pay particular attention to national constitutional arrangements for global constitutionalism to pursue structural coupling, from the perspective of the Korean government under the KORUS-FTA. Regarding this, the thesis proposes two general directions that the nation-state can take: current GIL needs to enhance participation which exposes itself to more diversified social contexts by promoting openness, on the one hand. It should also protect the autopoietic networking of investment arbitration from inappropriate external influences, on the other hand.

A. Greater participation in the norm-making process

In terms of participation procedures, nation-states should encourage the democratic participation of civil society groups in treaty-making. At the national level, nation-states should promote the openness of and participation in treaty-making procedures by introducing more social groups into the treaty-making mechanism. In fact, participation and openness are gaining significance in the globalised world in which international treaties are involved more directly in the

¹¹⁴ Sang Hie Han, 'Constitutional Analysis on the Expropriation Clause of the KORUS FTA' (2007) 9 Sugang Legal Study.

¹¹⁵ Soun-Young Eum, 'The Globalization of Law and KORUS FTA: The Necessary Condition in Validity of Treaties and the Validity of KORUS FTA' (2007) 15(1) Legal Studies.

lives of ordinary people.¹¹⁶ However, Korean legal procedures for treaty-making do not guarantee sufficient openness from the perspective of participation. While government officials of the executive branch are initiating and negotiating FTAs, the legislative branch and other social groups have had comparatively few chances to be engaged in treaty-making procedures.

The Korean legislative branch does not usually become involved in the treaty-making process until the executive branch submits the relevant bill for consent. In the Korean constitutional system, the President has the constitutional power to conclude and ratify treaties,¹¹⁷ whereas the legislature only has a right to consent to some constitutionally important treaties. These include ‘treaties pertaining to any restriction in sovereignty’, ‘treaties which will burden the State or the people with an important financial obligation’, or ‘treaties related to legislative matters’.¹¹⁸ Although there is no clear doctrinal standard for defining a constitutionally important treaty,¹¹⁹ in practice, the executive branch almost always submits a bill for legislative consent for FTAs to the National Assembly because FTAs are considered to be a typical type of constitutionally important treaty requiring legislative approval. Moreover, according to the general practice of treaty making, the executive branch has taken all major steps towards the conclusion of the treaty in accordance with its internal procedures on treaty-making even before legislative approval is sought.¹²⁰

Since 2004, the Korean government has negotiated and concluded FTAs mainly according to the ‘Presidential Directive on the FTA Conclusion Procedure’.¹²¹ This administrative rule has been revised to increase public and legislative participation at times when FTAs are expected to be

¹¹⁶ Soun-Young Eum, ‘Democratic Control over the Globalization of the Law’ (2005) 28 *Democratic Legal Studies*; Eum (n 115).

¹¹⁷ Korean Constitution Article 73: The President shall conclude and ratify treaties; accredit, receive or dispatch diplomatic envoys; and declare war and conclude peace.

¹¹⁸ Korean Constitution Article 60:

- (1) The National Assembly shall have the right to consent to the conclusion and ratification of treaties pertaining to mutual assistance or mutual security; treaties concerning important international organizations; treaties of friendship, trade and navigation; treaties pertaining to any restriction in sovereignty; peace treaties; treaties which will burden the State or people with an important financial obligation; or treaties related to legislative matters
- (2) The National Assembly shall also have the right to consent to the declaration of war, the dispatch of armed forces to foreign states, or the stationing of alien forces in the territory of the Republic of Korea.

¹¹⁹ See generally Jibong Lim, ‘Treaties Requiring the Consent of the Legislature in the Perspective of Constitutional Law – Focusing on the Korean Case’ (2004) 32(3) *Public Law* pp.163-78.

¹²⁰ Jibong Lim, ‘Korean National Assembly’s Control Power in Treaty-making’ (2008) 14(3) *Constitutional Law Study* pp.133-42.

¹²¹ Under Korean public law, this form of directive is categorised as an administrative rule or administrative order promulgated by the executive branch in order to implement the procedures for a particular administration.

controversial. In particular, this directive was amended by the 'Presidential Directive on Deliberations of FTA Conclusion and Implementation' (hereafter 'FTA Directive') following the conclusion of the Korea-EU FTA, in order to address certain weak points such as scant public and legislative participation. However, despite frequent amendments to the administrative rules governing FTA negotiation, the Korean social movement has consistently criticised the participatory deficit pertaining to the previous institutional framework. During the political debate over the KORUS-FTA in particular, the Korean opposition party criticised the secret negotiation and conclusion of the treaty by a handful of high ranking diplomats.¹²² They argued for the enhancement of public participation and greater legislative control over the overall institutional framework for FTA negotiation and implementation by stressing the need for more involvement of the National Assembly in the decision making.¹²³ They considered the passage of legislative statutes governing the FTA-making process as a first step to securing effective control over FTA policy against the executive branch and the governing party. In January 2012, the governing party and executive branch agreed to pass the Korean Trade Procedure Act in order to appease opposition parties. This new statute will be effective from 18 July 2012.

Under the FTA directive and Korean Trade Procedure Act, the Ministerial Meeting on Foreign Economic Affairs (hereafter 'MMFEA') has the authority to initiate FTA negotiations between Korea and other states. The MMFEA, chaired by the Minister of Strategy and Finance, is composed of cabinet ministers who take charge of overall issues pertaining to national economic matters. The Free Trade Agreement Opportunity Committee (hereafter 'FTAOC'), established under the FTA Directive, can also recommend that the MMFEA launch FTA negotiations.¹²⁴ The Minister for Trade chairs this committee, which is composed of assistant ministers from the relevant ministries, according to Article 5 of the FTA Directive.¹²⁵ Assistant ministers attending the FTAOC coordinate the various policies of each ministry during FTA negotiations.¹²⁶ The Korean Trade Procedure Act requires the Minister of Foreign Affairs and Trade to assess the feasibility of concluding the relevant FTA.¹²⁷ Although the Korean Trade Procedure Act does not specify who

¹²² Soun-Young Eum, 'The Globalization of Law: The Legal Character of the Treaty-Making Power and of the Consent of the Legislature to Treaty-Making' (2006) 32 Democratic Legal Studies pp.207-08.

¹²³ Dong Suk Oh, 'A Critical Study on the Negotiation of Korea-US FTA' (2006) 32 Democratic Legal Studies pp.151-82.

¹²⁴ Presidential Directive on Deliberations of FTA Conclusion and Implementation (FTA Directive) Article 13-16.

¹²⁵ Jong Bum Kim, 'Korea's Institutional Framework for FTA Negotiations and Administration: Tariffs and Rules of Origin' in Seung Wha Chang and Won-Mog Choi (eds), *Trade Law and Regulation in Korea* (Edward Elgar, 2011) p.165.

¹²⁶ *ibid.*

¹²⁷ Conclusion Procedure and Implementation of Trade Treaty (Korean Trade Procedure Act) Article 9.

exactly should perform this feasibility assessment, the Minister is likely to assign this task to the FTAOC. This body deliberates on the general orientation of future FTA policy, as well as the feasibility of concluding relevant FTAs and their national effects.¹²⁸ The FTA Directive allows the FTAOC to form a Private Advisory Committee in which civil trade experts can provide specialist advice.¹²⁹ The Private Advisory Committee of the FTAOC could serve as a channel through which civil society interests may be represented at the inter-ministerial level. The FTAOC's chairperson can appoint advisory committee members from those with extensive knowledge and experience of the international economic sector, or those who can represent the opinions of relevant interest groups.¹³⁰ Before negotiations begin, the Minister of Foreign Affairs and Trade should establish plans concerning the conclusion of a trade treaty, known as a 'Trade Treaty Conclusion Plan'.¹³¹ The current system requires a public hearing before both the establishment of a Trade Treaty Conclusion Plan¹³² and before the launch of a proposed FTA negotiation.¹³³ In addition, the Korea Trade Procedure Act requires the Minister of Foreign Affairs and Trade to establish a Trade Advisory Committee within the Ministry of Foreign Affairs and Trade.¹³⁴

Established under the control of the Minister of Strategy and Finance, the Free Trade Agreements Domestic Measures Committee (FTADMC) is also designed to obtain public support for the conclusion and ratification of FTAs through cooperation between government and civil society.¹³⁵ The FTADMC provides the public with relevant information on the conclusion of FTAs and considers opinions from various strata of society, whilst supporting legislative activities associated with FTA conclusion, ratification and approval.¹³⁶ The FTADMC is intended to generate a government-civil society partnership and it is therefore composed of both officials and civilians (unlike the FTAOC). Additionally, the Committee is co-chaired by the Minister of Strategy and Finance together with a civilian member appointed by that Minister.¹³⁷ Like the FTAOC, the FTADMC can form an advisory committee when deemed necessary.¹³⁸ It should report public opinion on FTAs to the President on a regular basis,¹³⁹ and can request cooperation

¹²⁸ Kim (n 125) p.165.

¹²⁹ *ibid.*

¹³⁰ FTA Directive Article 10.

¹³¹ Korean Trade Procedure Act Article 6(1).

¹³² *ibid* Article 7.

¹³³ FTA Directive Article 12.

¹³⁴ Korean Trade Procedure Act Article 21.

¹³⁵ FTADMC Official Website <<http://fta.korea.kr/kr/intro/greet/01/>> accessed 15 April 2012.

¹³⁶ Free Trade Agreements Domestic Measures Committee Decree (FTADMC Decree) Article 2.

¹³⁷ *ibid* Article 3.

¹³⁸ *ibid* Article 6.

¹³⁹ *ibid* Article 7.

from relevant institutions and groups if it is in need of a specialist opinion or relevant information from government officials or civil experts.¹⁴⁰

Despite the relatively frequent upgrades in the institutional framework for FTA negotiation, the executive branch could still be said to dominate FTA-making. The decision-making structure for negotiating and concluding these agreements is vulnerable to inappropriate influences from politics and the economy. Although each ministry in the FTAOC is supposed to represent various social interests in the treaty-making process, they are homogeneous in the sense that the committee is composed solely of internal government officials. Moreover, government officials must generally follow the political goals of the governing party or may be ideologically aligned with major business actors. Consequently, urgent social needs tend to be distorted by a small number of government officials or experts who are inclined to favour certain economic or political interests.

In response to this deficiency, the newly established Korean Trade Procedure Act prescribes that anyone can present opinions concerning a trade treaty or agreement.¹⁴¹ However, it is unclear whether the authorities have any binding obligation to consider those opinions because the Act allows the government to consider such opinions ‘if the government finds the opinions reasonable’.¹⁴² As such, the executive branch actually has fundamental discretion over whether or not to accept public opinion.

Of course, this general clause is implemented mainly through several committees whose task is to consider the interests of civil society. However, several of these procedures for participation are used merely as instruments of support for the government decisions of technobureaucratic elites. Whilst there are a number of committees through which civil experts can engage in FTA policy making, there are no clear standards by which such committees can secure their independence or autonomy, as their members are appointed by government officials. Consequently, the system remains relatively closed to direct input from civil society. Worse, those committees which are intended to promote government-civil society partnership do not appear to make a substantial contribution to democratic participation. In fact, it is unclear whether such committees have any meaningful influence on the FTA decision-making process. For example, the opinions of private advisory committees can only have a supportive role in government deliberations on FTA negotiations because they have no legally binding force. In addition, it is not

¹⁴⁰ *ibid* Article 8.

¹⁴¹ Korean Trade Procedure Act Article 8.

¹⁴² *ibid*.

clear how the public opinion collected by the FTAMDC can be brought to bear on the decisions of government committees like the FTAOC or MMFEA, who take practical charge of FTA matters, in any legally binding sense.

It follows that other relevant actors, such as trade unions or NGOs, take part in decision-making processes only as subordinate or even tokenistic partners, thus giving the mere appearance of democratic participation. Therefore, it is perhaps unsurprising that civil society views the numerous government measures designed to increase participation and transparency in decision making with extreme cynicism. At the same time, one cannot expect an independent committee to have the constitutional authority to bind democratically elected institutions to a given point of view.

In this context, the participation of the National Assembly as another constitutional organ could serve to alleviate the executive branch's domination of FTA practices. However, despite the constitutional function of the legislative branch in formally representing public opinion, the National Assembly plays a very limited role in the process of treaty-making. In fact, legislative controls are quite often impeded by lack of information and expertise. The legislature has a mere symbolic function because it cannot reconsider the substantive details of the treaty after its conclusion by plenipotentiaries from both sides of the negotiations. This leads to constitutional claims: some critics argue that the executive branch has infringed upon the powers of the legislature in concluding the KORUS-FTA because it forged ahead unilaterally with the U.S. FTA negotiations, showing reluctance to furnish the Korean public with the relevant information. It is said that 'the administration has monopolized FTA-related information and carried out negotiations in a hasty, unfaithful and unilateral manner'.¹⁴³ Thus, 23 Korean lawmakers raised a constitutional claim against the KORUS-FTA based on a lack of transparent disclosure of negotiation information. Notably, they criticised the executive branch for monopolising FTA-related information and systematically hindering legislative intervention. However, the Korean Constitutional Court avoided a substantive review on this point by deciding the case on the basis of a procedural requirement for constitutional claims. The Court held that the constitutional power of the National Assembly is granted not to individual members of the National Assembly but to the National Assembly as an institution. Therefore, the Court argued that individual law-makers as members of

¹⁴³ Yonhap News, 'Lawmakers Launch Lawsuit against South Korea-U.S. FTA Talks' *The Hankyoreh* (7 September 2006) <http://www.hani.co.kr/arti/english_edition/e_national/155156.html> accessed 15 April 2012.

the National Assembly have no legitimate standing to raise a constitutional claim of infringement upon the constitutional power of the National Assembly.¹⁴⁴

The new Korean Trade Procedure Act seeks to respond to some of the criticisms concerning the role of the National Assembly in treaty negotiations. Under the new framework, the government should present information about FTA negotiations and their implementation to the National Assembly and the public.¹⁴⁵ The Minister of Foreign Affairs and Trade should report plans concerning the conclusion of a trade treaty¹⁴⁶ and other important issues.¹⁴⁷ In addition, the National Assembly can ask the executive branch to negotiate and conclude treaties in accordance with the Korean Trade Procedure Act in the case that the executive branch refuses to follow the Act on the ground that the relevant treaty is not a trade treaty defined under the Act.¹⁴⁸ The National Assembly also can request the executive branch to submit a bill of approval for a treaty or agreement if the National Assembly recognises it as a trade treaty.¹⁴⁹ The executive branch cannot therefore argue that a relevant agreement does not require legislative approval under Article 60(1) of the Korean Constitution as long as the National Assembly defines that agreement as falling within the concept of ‘trade treaty’ under Article 2 of the Korean Trade Procedure Act. Furthermore, the National Assembly can present its opinions regarding reported FTA issues,¹⁵⁰ and can establish a special committee to monitor the FTA negotiation process of the executive branch.¹⁵¹ Although transparency towards the legislature has increased, the current system invites many questions as to whether or how legislative inputs can be influential on the decision making process for FTAs. Indeed, no special legislative committee has any formal legal authority to control negotiations themselves.¹⁵²

As a result, the Korean government should adopt more sophisticated procedural instruments to promote participation by social actors. Of course, there is a risk that efficient and strategic negotiations between two state parties could be crippled if social activists intentionally abuse the value of participation in order to delay the treaty-making process. Moreover, in terms of

¹⁴⁴ 19-2 KCCR 436, 2006Hun-Ra5, October 25, 2007.

¹⁴⁵ According to Article 4 of the Korean Trade Procedure Act, the executive branch can keep some information confidential if it is in the public interest and relates to a successful negotiation strategy. Nevertheless, the government cannot refuse the disclosure of even sensitive issues if the President of the National Assembly, based on a legislative resolution, asks the government to reveal the relevant information.

¹⁴⁶ Korean Trade Procedure Act Article 6(2).

¹⁴⁷ *ibid* Article 10(2). See also FTA Directive Article 21.

¹⁴⁸ Korean Trade Procedure Act Article 6(3).

¹⁴⁹ *ibid* Article 13(3).

¹⁵⁰ *ibid* Article 10(3).

¹⁵¹ Kim (n 125) p.167.

¹⁵² *ibid*.

transparency, it is very difficult for trade policy makers to reveal the details of the negotiation process to the public because negotiation strategy needs to some extent to remain confidential from the other party; negotiators cannot arrive at a successful agreement without hidden cards. Nevertheless, public support is critical to successful negotiations, conclusions and, eventually, the stable operation of an FTA, to the extent that its detailed technical contents are anticipated to have a significant influence on the national interests and everyday lives of ordinary people. This trend is found in a series of recent events associated with Korean trade policy. In 2008, the newly elected President's trade policy was to deregulate imports of U.S. beef, which other countries had barred because of mad cow disease. This policy, enacted without the public's support, provoked a huge nationwide protest for several months; the President was forced to apologize for his mistake.¹⁵³ In the end, Korean public pressure made the U.S. administration consider an alternative policy regarding beef exports.

In practice, this mechanism causes a chronic, repeated and similar pattern of problems in Korean constitutional practice. Here, the executive branch launches and pushes negotiation unilaterally without sufficient participation and disclosure of information. Later, the investment treaty catches the public's attention suddenly – at the eleventh hour of treaty-making – when it is discussed in the National Assembly for legislative approval. Lack of participation in the initial stages of treaty-making could subject investment treaties with politically controversial countries such as the U.S. to greater obstacles regardless of their contents, as illustrated in a comparison between the KORUS-FTA and other FTAs.¹⁵⁴ Taking the example of the KORUS-FTA, as the substantive details of that FTA were revealed to the public, the Korean people realised that they had been furnished with insufficient knowledge of the treaty and inadequate opportunities to present their own views in the early stages of its formation. Further, KORUS-FTA opposition groups attempted to exaggerate the possible risks, whereas the Korean government underplayed these risks. Meanwhile, the public became sympathetic to conspiracy theories about the government hiding something. This spread very quickly through social networking users, motivated by ideological drivers including anti-capitalist and anti-American sentiment.¹⁵⁵

¹⁵³ Seo-Soon Song, 'Study on Unconstitutionality of US Beef Deal' (2008) 3 Studies of European Constitution.

¹⁵⁴ See Chapter I.

¹⁵⁵ In relation to the KORUS-FTA, Korean Supreme Prosecutor's Office faced severe public criticism as it attempted to interrogate the internet users who spread the 'anti-FTA rumours'. See Si-Soo Park, 'SNS Crackdown on FTA Rumors Sparks Backlash' *The Korea Times* (9 November 2011) <http://www.koreatimes.co.kr/www/news/nation/2011/11/116_98439.html> accessed 15 April 2012

Although the KORUS-FTA has already been effective, lack of participation can still work to unsettle its future operation. As discussed in relation to systems theory, normative expectations should be re-adjusted appropriately according to circumstantial changes in order to attract the relevant actors for the effectiveness of the GIR; in other words, actors will withdraw commitment to the regime if it imposes too severe burden on them without securing their minimum interests.¹⁵⁶ The GIR can maintain its effectiveness when it can facilitate participation mechanisms to change normative expectations, namely norms, under a general consensus among the relevant regime actors and according to the legitimate procedure. In the context of the KORUS-FTA, if its implementation would cause unbearable social problems for the Korean public, its long-term stable operation could face public resistance as illustrated by the mad-cow row.¹⁵⁷

Korea needs to establish a more sophisticated constitutional setting encompassing democratic control by the legislature and the efficient executive negotiation in treaty-making. Of course, it would be impetuous to claim that all critical views concerning FTAs are unfounded. If one considers the KORUS-FTA ratification experience, it could nevertheless be said that unnecessary and extreme public resistance could be spared in advance by delivering democratic participation and transparency to the public. In this context, Korea can enjoy the economic benefits of FTAs fully only when they are founded on general public support and cooperation from civil society. The Korean government must be able to guarantee the stable operation of FTAs in practice to attract more foreign investment and maximise the benefits of these agreements. However attractive the terms of an FTA may be, foreign actors would not expand their investment or trade into the Korean market if implementation of those terms is unstable. In this context, this thesis proposes several policy suggestions in relation to the institutional framework of Korean FTA making process:

Firstly, the National Assembly must incorporate the key negotiation goals for investment treaties into the Korean Trade Procedure Act in a similar way to the U.S. Trade Act of 2002. Even if this takes a long time, the governing and opposition parties should patiently review and discuss every issue that the various social interest groups have raised regarding foreign trade policies, because such negotiation goals will ultimately be presumed non-negotiable core national interests.

¹⁵⁶ UNCTAD, 'UNCTAD IIA Issues Note, Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims' (December 2010) <http://www.unctad.org/en/docs/webdiaeia20106_en.pdf> accessed 15 April 2012

¹⁵⁷ Actually, the Korean opposition party has already expressed a intention to terminate the KORUS-FTA. See Chosun Ilbo, 'Han Myeong-sook "I am a pro-DJ" and "I Will Terminate the KORUS-FTA"' *Chosun Ilbo* (15 January 2012) <http://news.chosun.com/site/data/html_dir/2012/01/15/2012011501366.html?news_topR> accessed 15 April 2012.

Secondly, the legislature should instruct the executive branch to negotiate in accordance with those policy goals. At the same time, it is worth noting that the internal processes of the executive branch should not completely neglect the value of participation and openness. At minimum, the government needs to introduce measures to secure the autonomy of deliberative bodies, such as the private advisory committee or the KTADMC. For example, the civil members of the FTAMDC or the private advisory body should be appointed on the basis of a recommendation by the relevant civil group. In addition, the FTAMDC should be involved in the early stages of launching FTA negotiations by participating in the FTAOC or MMFEA. In order to secure substantial influence over decision-making, it is worth considering that the FTA Directive requires the approval of the FTADMC and of a private advisory body's social and economic effect study of a prospective FTA before any official announcement of FTA negotiations. Such measures could make the normative content of the FTA effectively reflexive to other social contexts before the treaty itself is concluded by the dominant political or economic actors.

In addition, the Korean government needs to establish its own model of investment law, which purports to reflect the key negotiation goals. It is highly questionable that the other negotiating state party will take a Korean model treaty seriously. However, it also looks unrealistic to expect a Korean model BIT to be completely ignored in bilateral negotiations. For instance, the Korean government has incorporated several Korean national doctrines into the indirect expropriation provisions of the KORSU-FTA, in spite its unequal bargaining power vis-a-vis the U.S. Given this experience, the establishment of a Korean Model BIT could mitigate the dominant position of the model investment treaty of stronger countries, so as to create a global momentum towards a fairer model investment treaty. At minimum, it could enhance the chance to update the Model BIT of stronger countries in a different way from what such countries intended.¹⁵⁸

Thirdly, the legislature must mainly review whether the executive branch has reflected the negotiation goals sufficiently and reasonably in the investment treaty before approving the treaty. Although party politics cannot eradicate all risk of political turmoil between the governing party and the opposition party concerning legislative approval of a treaty, unnecessary and destructive political quarrel would be saved to the extent that a general consensus is reached in advance.

Lastly, Korea should take steps to establish a structural mechanism to oversee the implementation of the investment treaty, in order to reduce the risk of instability in implementation.

¹⁵⁸ This could serve as another role to allow the nation-state to be indirectly involved in the tribunal's interpretation of the treaty. See Chapter IV.

Such a mechanism would aid both parties to circumvent and remedy any potential problems before they become too serious. Korea's establishment of a new institutional framework to oversee the implementation of the Korea-EU FTA is a positive step. Indeed, the Korean Trade Procedure Act requires the Minister of Foreign Affairs and Trade to assess the implementation of any FTA that came into effect within the last 10 years.¹⁵⁹ The Minister should assess the following: the economic effects of the trade agreement; the feasibility and reform of domestic measures to support vulnerable industries; issues discussed in the joint committee for the FTA; and any other issues that the Minister deems necessary.¹⁶⁰ In addition, Article 17 of the Korean Trade Procedure Act requires the government to take appropriate measures, including re-negotiation, where the implementation of a treaty causes unrecoverable domestic harm in relation to a specific item for trading.

Nevertheless, it remains unclear how Korean civil society or the legislature could be involved in this process because the government has not yet provided any clear procedures for conducting the implementation assessment. Indeed, the executive branch has discretion over how to shape the future institutional design of the oversight of FTA implementation by virtue of Article 15(3) of the Korean Trade Procedure Act, which allows it to prescribe specific procedural rules through a presidential decree, rather than legislative enactment. Moreover, the Korean Trade Procedure Act fails to address whether and how civil society or the legislature can push the executive branch to propose a re-negotiation of an FTA.

It is suggested that an institutional mechanism for FTA practice should allow civil society and the legislature to participate in any implementation assessment. Further, Korean civil society should be allowed to effectively recommend that the executive branch initiate discussion about serious problems in the KORUS-FTA Joint Committee if the assessment discovers serious problems concerning its implementation. In this regard, the Korea-EU FTA suggests an impressive example for participation; Article 15.1.4 of the Korea-EU FTA states that the Trade Committee – which is similar to the KORUS-FTA Joint Committee – can ‘communicate with all interested parties including private sector and civil society organisations’. A specific model of participation in the Trade Committee can be developed at the bilateral level between the two contracting parties.¹⁶¹ At the same time, the Korean government can and should take seriously the creation of an

¹⁵⁹ Korean Trade Procedure Act Article 15(1).

¹⁶⁰ *ibid.*

¹⁶¹ James Harrison, ‘Transparency and Public Participation in International Economic Law – A Case Study of the Korea-EU Free Trade Agreement’ (2011) 5(1) *Sungkyunkwan Journal of Science & Technology* (proposing a plausible institutional mechanism to secure participation in the context of the Korea-EU FTA).

institutional link between an international organisation, such as the KORUS-FTA Joint Committee, and national procedure that promotes participation in the KORUS-FTA Joint Committee at the national level.

B. Protection of the autopoietic operation of investment arbitration

The nation-state should protect the autopoietic operations of independent dispute settlement from the inappropriate influences of global actors, including the nation-state itself. The independence of the arbitrator and arbitration system is very controversial, although several recent empirical studies have not produced any meaningful data to show a bias in investment arbitration.¹⁶² Some commentators have pointed out that these empirical researches need to be refined further.¹⁶³ Moreover, they point out numerous circumstantial evidence to show arbitrator bias. For example, at a conference David Schneiderman disclosed that the arbitrator was under political pressure from the United States in the *Loewen* case, where the U.S. government was a respondent state.¹⁶⁴ It might not be unreasonable to cast doubt on the independence of the *Loewen* tribunal in the sense that the final decision was made in favour of the U.S. government, although there is no obvious evidence indicating that the political pressure alluded to really worked. At the same time, it is still true that the overall culture of the professional group is influenced more directly by the market power of global investors as real customers and the political hegemony of strong developed countries as global standard setters, than by the civil society – although more profound sociological and empirical research is required.¹⁶⁵

Regarding the impartiality of investment arbitration, legal scholarship has not yet proposed plausible solutions to safeguard the judicial independence of investment arbitrators. Whilst this thesis demonstrates that sensitivity to reputation can control the behaviour of individual arbitrators,¹⁶⁶ given that investment remains dominated by western-oriented, investor-friendly legal cultures, it seems doubtful that the independence of global investment arbitration will be secured by the innate dynamic of reputation damages alone.¹⁶⁷ Harten therefore argues that the investment arbitration system needs to borrow elements from the public court system in relation to appointment

¹⁶² Susan D. Franck, 'Development and Outcomes of Investment Treaty Arbitration' (2009) 50(2) Harvard International Law Journal.

¹⁶³ Gus Van Harten, 'Procedure in Investment Treaty Arbitration and the Relevance of Comparative Public Law' in Stephen Schill (ed) *International Investment Law and Comparative Public Law* (Oxford University Press, 2010) pp.653-54.

¹⁶⁴ Franck (n 162) pp.486-87.

¹⁶⁵ Harten (n 163) pp.648-51.

¹⁶⁶ See Chapter IV. Part IV. D.

¹⁶⁷ Harten (n 163) p.655.

processes, such as security of tenure.¹⁶⁸ However, such public law analogies may serve as an institutional shield to protect biased arbitrators from public criticism, as sensitivity to reputational damage in this field is less acute. Consequently, this thesis admits that the independence issue has yet to be discussed further in light of more compelling social and empirical evidence in this regard.

This thesis therefore simply proposes several minimum conditions for protecting the autopoietic operation of the investment arbitration system. Those proposals aim to create a context in which arbitration can secure its independence by exposing itself equally to other social influences whilst protecting itself from inappropriate influences. Here, the nation-state should pay attention to designing procedural contexts, rather than controlling substantive decisions directly. Of course, meeting those conditions might not solve all the problems of GIL. However, any ambitious investor-state arbitration reform may not maximise the benefits of contextual control through structural coupling without meeting those conditions. In this regard, the thesis argues that the KORUS-FTA requires further improvement in favour of structural coupling.

i) Participation of a non-disputing third party

Amicus Curiae or the participation of non-disputing parties in arbitration proceedings could promote the internal dynamic for autonomy of arbitration through the creative use of anxiety relevant to reputational damages. The sensitivity of arbitrators and arbitration as whole to reputational damage and legitimacy crisis is proportionate to the degree of structural coupling. In other words, the capacity to secure independence through an autopoietic network of legal decisions depends on the extent to which the system is simultaneously and commensurately open to extra-legal influences. Nevertheless, the political influences of nation-states and the economic power of global investors are relatively huge because on one hand, nation-states retain the formal capacity to change the system itself,¹⁶⁹ and on the other hand, global investors are customers with the right to use arbitration services.¹⁷⁰ When compared to this, it is hard to deny that the influence of social movements remains relatively less formal and less significant, although some practitioners recognise the emerging power of public scrutiny exercised by a critical civil society and academia.¹⁷¹ In this context, the participation of a non-disputing third party, such as civil groups, serves as a more significant and formal tool for a social movement to imbue the arbitration with

¹⁶⁸ *ibid.* See also Gus Van Harten, 'Reform of Investor-State Arbitration: A Perspective from Canada' (2011) <<http://ssrn.com/paper=1960729>> accessed 15 April 2012.

¹⁶⁹ Charles N. Brower and Stephen W. Schill, 'Is Arbitration a Threat or a Boom to the Legitimacy of International Investment Law' (2009) 9(2) *Chicago Journal of International Law* pp.495-96.

¹⁷⁰ Harten (n 163) pp.648-51.

¹⁷¹ Brower and Schill (n 169) pp.492-93.

various social values. This mechanism is gaining significance in securing the independence of GIL practices.¹⁷² In practice, some tribunals, even without any clear provision for *amicus curiae*, accept *amicus* submissions from non-government organisations or municipal authorities,¹⁷³ as illustrated by the *Methanex*¹⁷⁴ and *UPS* cases.¹⁷⁵ In the *Methanex* case,¹⁷⁶ the tribunal justified its discretion to consider *amicus* briefs on the ground that Article 15(1) of the UNCITRAL Arbitration Rules (revised as Article 17(1) in 2010) allows the tribunal to ‘conduct the arbitration in such manner as it considers appropriate’.¹⁷⁷ Finally, in 2003, the NAFTA Free Trade Commission issued a statement recommending ‘non-disputing party participation’ in the Chapter 11 arbitration proceedings.¹⁷⁸ In light of the ICSID system, the ICSID tribunal upheld the consideration of *amicus curiae* with similar reasoning to the *Methanex* and *UPS* cases on the basis of the ICSID Additional Facility Rules.¹⁷⁹ This strand of practices had some influence on the amendment of ICSID Arbitration Rule 37(2) and the 2004 U.S. Model BIT, Article 28(3) in allowing *amicus curiae*. Through such admissibility, the decision-making process in producing legal rules can be sensitive to other social values than political or economic values under the public interest. In this vein, the *Methanex* tribunal recognised the public character of the dispute on the ground, not of its relation to the state, but of the fact that its subject-matter was closely related to the general public.¹⁸⁰ This will enhance the independence, and eventually legitimacy, of the arbitration system from the corruption or bias that makes the entire system less attractive to GIR members.

¹⁷² See generally James Harrison, ‘Recent Developments to Promote Transparency and Public Participation in Investment Treaty Arbitration’ (2010) L’Observateur des Nations Unies pp.131-37.

¹⁷³ Steve Charnovitz, ‘Nongovernmental Organizations and International Law’ (2006) 100(2) The American Journal of International Law pp.353-54.

¹⁷⁴ *Methanex Corporation v. United States of America*, UNCITRAL (NAFTA), Decision of the Tribunal on Petitions from Third Persons to Intervene as “Amici Curiae”, 15 January 2001. See also *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A v. Argentine Republic*, ICSID No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as Amicus Curiae, 19 May 2005.

¹⁷⁵ *United Parcel Service of America Inc.(UPS) v. Government of Canada*, UNCITRAL (NAFTA), Decision of the Tribunal on Petitions for intervention and Participation as Amici Curiae, 17 October 2001.

¹⁷⁶ See generally Patrick Dumberry, ‘The Admissibility of Amicus Curiae Briefs by NGOs in Investors-States Arbitration: The Precedent Set by the Methanex Case in the Context of NAFTA Chapter 11 proceedings’ (2001) 1(3) Non-State Actors and International Law; Howard Mann, ‘Opening the Doors, At least a Little: Comment on the Amicus Decision in Methanex v. United States’ (2001) 10(2) Review of European Community & International Environmental Law.

¹⁷⁷ *Methanex v. United States of America* (n 174) paras.24-31.

¹⁷⁸ NAFTA Free Trade Commission, ‘Statement of the Free Trade Commission on Non-disputing Party Participation’ (2003) <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Nondisputing-en.pdf>> accessed 15 April 2012.

¹⁷⁹ *Suez v. Argentine Republic* (n 174).

¹⁸⁰ *Methanex v. United States of America* (n 174) para.49.

Korea and the U.S. have agreed to allow the participation of non-disputing parties in proceedings by adjusting the 2004 U.S. Model BIT.¹⁸¹ Thus, Article 11.20.4 of the KORUS-FTA allows non-disputing parties to make ‘oral and written submissions to the tribunal regarding the interpretation’ of the KORUS-FTA. The Agreement enumerates several conditions which the tribunal should consider in deciding whether or not to accept a written submission from non-disputing parties. The KORUS-FTA prescribes the forms of the submission so as to allow only ‘oral and written submission’¹⁸² by contrast to the 2004 U.S. Model BIT, which does not specify the form of submission in particular. Moreover, the submission should ‘assist the tribunal in the determination of a factual or legal issue related to the proceedings by bringing a perspective, particular knowledge, or insight that is different from that of the disputing parties’.¹⁸³ In addition, the submission by the non-disputing parties should deal with ‘a matter within the scope of the dispute’¹⁸⁴ and be concerned with ‘a significant interest in the proceedings’.¹⁸⁵ Notably, the KORUS-FTA clearly prescribes that participation by non-disputing parties shall not cause disruptions in the proceedings, nor any undue burden or unfair prejudice towards any disputing party. Moreover, the Agreement allows the disputing parties to present their own opinions regarding participation of non-disputing parties.¹⁸⁶

Despite this important development, there is no clear rule for permitting the participation of non-disputing parties in proceedings. This does not mean that the tribunal’s discretion to allow or reject the participation of non-disputing parties is unlimited. There are several commonalities that the investment tribunal shares in determining whether a non-disputing party is allowed to participate in proceedings.¹⁸⁷ Thus it is difficult for a tribunal to reject the participation of a non-disputing party as long as the petitioner can prove that his or her submission meets the following conditions. Firstly, the submission of *amicus curiae* should be related to the public interest; the *Methanex* tribunal recognised the public character of the dispute on the grounds not of its state-relation but of the fact that its subject-matter was closely related to the general public.¹⁸⁸ Thereafter, the *UPS* arbitration under NAFTA’s Chapter 11 followed the reasoning of the *Methanex* decision

¹⁸¹ Soo-Bong Jeong, *Analysis on KORUS-FTA Investment Chapter* (Ministry of Justice in Republic of Korea, 2008) pp.254-55; Harrison (n 172) p.132.

¹⁸² KORUS-FTA Article 11.20.4.

¹⁸³ *ibid* Article 11.20.5(a).

¹⁸⁴ *ibid* Article 11.20.5(b).

¹⁸⁵ *ibid* Article 11.20.5(c).

¹⁸⁶ *ibid* Article 11.20.5.

¹⁸⁷ Harrison (n 172) pp.133-36.

¹⁸⁸ *Methanex v. United States of America* (n 174) para.49. See also *Suez v. Argentine Republic* (n 174) para.19.

on third party participation.¹⁸⁹ Through such admissibility, the decision-making process for producing legal norms can be sensitive to other social values under the public interest. Secondly, the submission of *amicus curiae* is allowed when the tribunal admits that the submission can bring ‘expertise, experience, and independence’¹⁹⁰ in the context of ‘a perspective, particular knowledge, or insight that is different from that of the disputing parties’.¹⁹¹ Lastly, the submission should be clearly ‘within the scope of the dispute’¹⁹², because the non-disputing party in the investment arbitration should serve as a faithful supporter of the tribunal’s decision-making.¹⁹³

Nevertheless, the current system needs to go a step further in order to encourage the genuine function of participation of non-disputing parties. Future tribunals under the KORUS-FTA could impose some limits on the role of non-disputing parties.¹⁹⁴ In fact, investment arbitration does not require the attendance of non-disputing parties at the hearing. Moreover, the arbitrator can reject a request for the non-disputing party to attend the hearing, though the tribunal is not prevented from consulting the petitioner in relation to their written submission.¹⁹⁵ From this perspective, the KORUS-FTA should secure a right for non-disputing parties to participate in oral proceedings because greater engagement in these proceedings can encourage non-disputing parties to take a more active role, subjecting the tribunal to a greater diversity of views than just ‘a one-off submission’.¹⁹⁶

ii) Publication system

The Korean government should establish a publication system in which arbitration decisions are fairly and fully published as long as the case is associated with the public interest and publication is not severely contrary to the interests of the disputing parties. This should promote the autopoietic operation of the arbitration system. The issue is usually discussed in terms of the transparency principle.¹⁹⁷ In international commercial arbitration, the confidentiality of arbitration procedures is one of the practical reasons for private business actors to decide to choose informal private arbitration. Generally speaking, disputants prefer to have their cases heard in private for practical reasons; for example, their business reputations might be damaged if information about

¹⁸⁹ *UPS v. Government of Canada* (n 175).

¹⁹⁰ *Suez v. Argentine Republic* (n 174) para.19.

¹⁹¹ KORUS-FTA Article 11.20.5(c).

¹⁹² *ibid* Article 11.20.5(b).

¹⁹³ Harrison (n 172) pp.135.

¹⁹⁴ *ibid* p.136.

¹⁹⁵ *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania*, ICSID No. ARB/05/22, 2 February 2007 paras.64-65.

¹⁹⁶ Harrison (n 172) p.136.

¹⁹⁷ *ibid* pp.120-22.

the case were exposed to the public.¹⁹⁸ This confidentiality principle in international commercial arbitration has been adopted by investor-state arbitration in a bid to attract foreign investors. However, many critical commentators have argued that confidentiality in investor-arbitration leaves important public policy issues to a handful of investment practitioners.¹⁹⁹ They argue that public proceedings or access to the case information can indirectly place tribunals under public scrutiny. Transparency could render investment tribunals more impartial by increasing sensitivity of reputational damage to a greater variety of social contexts. In addition, some commentators point out that transparency could increase the legitimacy of individual arbitration decisions and of GIL as a whole.²⁰⁰ Against this backdrop, many arbitration rules and investment treaties have set minimum conditions for publicity and access to information.²⁰¹

From a systems theory perspective, transparency could be interpreted as an important factor in securing the autopoietic operation of arbitration. Furthermore, it does not collide with the long-term interests of global investors. One might argue that GIL could actually be derailed because foreign investors would not prefer a system where all information from proceedings is revealed to the public. However, such transparency is not necessarily against the interests of foreign investors because the publication of decisions makes arbitration outcomes more consistent and predictable. As discussed above, GIL functions according to the mechanisms of remembering and forgetting.²⁰² Communicative linkages based on the logic of remembering and forgetting can occur when previous communication is accessible to future communication.²⁰³ In other words, precedents must be available to communicative legal actors who raise normative claims. Therefore, every decision could become involved in the production of norms through the forgetting and remembering mechanism as soon as it is published.²⁰⁴

Taking the example of GIL, a tribunal can decide a present case by considering the legal points and reasoning of previous decisions. Through this process, global investment arbitration can produce more predictable and consistent rules by relying on the accumulation of cases. In this

¹⁹⁸ Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration* (Sweet & Maxwell, 2004) pp.32-37.

¹⁹⁹ Public Citizen, 'NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy' (2001) <<http://www.citizen.org/documents/ACF186.PDF>> accessed 15 April 2012.

²⁰⁰ Joachim Delaney and Daniel Barstow Magraw, 'Procedural Transparency' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) p.761-62; Harrison (n 172) pp.121-22.

²⁰¹ Harrison (n 172) pp.122-31.

²⁰² Graft-Peter Calliess and Moritz Renner, 'Between Law and Social Norms: The Evolution of Global Governance' (2009) 22(2) *Ratio Juris* p.268.

²⁰³ *ibid* p.269.

²⁰⁴ *ibid* p.275.

process, some decisions are followed if arbitrators find them convincing. Others are rejected if arbitrators consider them unpersuasive. The minimum condition to making such operations workable is that the system makes the body of cases available to future arbitrators. Indeed, some arbitration decisions are unofficially published through academic journals such as *International Legal Materials* or internet databases such as *Investment Treaty Arbitration*.²⁰⁵ However, such an unofficial publication system does not provide all decisions, because editors tend to choose decisions that they consider significant, or because the editors are not legally qualified to collect all the relevant information from disputing parties. On the other hand, an internet database, compared to a public court system, is not centralised and organised enough to be accessible to all decisions. Such biased or incomplete information about decisions can deter a future tribunal from comparing legal arguments from similar cases fairly in the course of the forgetting and remembering mechanism.

In this context, arbitration decisions, or the key legal reasoning behind them, should be accessible through a formal publication system, even if some of the information about proceedings is withheld from the public because of significant public interest factors, such as national security, or due to intolerable harm to business. In actuality, the KORUS-FTA requires respondents to make relevant information promptly available to the public.²⁰⁶ In addition, the tribunal is required to make ‘hearings open to the public’ in accordance with ‘the appropriate logistical arrangements’.²⁰⁷ On the other hand, KORUS-FTA prescribes the measures and procedures required to protect information from the public or from other third parties. For example, a respondent state does not need to provide information related to the ‘Essential Security’ under Article 23.2²⁰⁸ and the

²⁰⁵ Investment Treaty Arbitration <http://italaw.com/chronological_list.htm> accessed 15 April 2012.

²⁰⁶ KORUS-FTA Article 11.21.1:

Subject to paragraphs 2, 3, and 4, the respondent shall, after receiving the following documents, promptly transmit them to the non-disputing Party and make them available to the public:

- (a) the notice of intent;
- (b) the notice of arbitration;
- (c) pleadings, memorials, and briefs submitted to the tribunal by a disputing party and any written submissions submitted pursuant to Article 11.20.4 and 11.20.5 and Article 11.25;
- (d) minutes or transcripts of hearings of the tribunal, where available; and
- (e) orders, awards, and decisions of the tribunal.

²⁰⁷ KORUS-FTA Article 11.21.2.

²⁰⁸ KORUS-FTA, Article 23.2 (Essential Security) (*footnote omitted*):

Nothing in this Agreement shall be construed:

- (a) to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or

‘Disclosure of Information’ under Article 23.4.²⁰⁹ In addition, Article 11.21.4 of the KORUS-FTA protects from public disclosure ‘protected information’ defined as ‘confidential business information or information that is privileged or otherwise protected from disclosure under a Party’s law’.²¹⁰ Here, the tribunal has the authority to decide whether information should be considered as ‘protected’. Moreover, a disputing party can request the Joint Committee to consider issuing a decision which determines the protected information.²¹¹

From the systems theory perspective, the KORUS-FTA’s transparency provisions seem to balance transparency with confidentiality. At the very least, the relevant provisions of Article 11.21 meet the minimum condition of the publication system because the ‘orders, awards, and decisions of the tribunal’ are principally available to the public, with some exceptions. Additionally, the Korean government should publish legal reasoning and excerpts in a similar way to that prescribed by ICSID Arbitration Rule 48(4).²¹² The Korean government therefore needs to promptly publish decisions and make them available to the public and especially to other arbitrators through a website or government official gazette, as done in the national public court system, by NAFTA state parties and on the ICSID website.²¹³

iii) Engagement in the interpretation of arbitration

Although the nation-state cannot influence investment arbitration *directly*, it can develop many instruments to guide the tribunal in interpretation of the treaty text *indirectly*.²¹⁴ The clearest engagement can be made through participation in the norm-making process. As seen in the new

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- (b) to preclude a Party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security or the protection of its own essential security interests.

²⁰⁹ KORUS-FTA, Article 23.4 (Disclosure of Information):

Nothing in this Agreement shall be construed to require a Party to furnish or allow access to confidential information the disclosure of which would impede law enforcement or otherwise be contrary to the public interest or which would prejudice the legitimate commercial interests of particular enterprises, public or private.

²¹⁰ KORUS-FTA Article 11.28.

²¹¹ *ibid* Article 11.21.4(e).

²¹² ICSID Arbitration Rule 48 (4): The Centre shall not publish the award without the consent of the parties. The Centre may, however, include in its publications excerpts of the legal rules applied by the Tribunal.

²¹³ For example, the U.S. government has published the NAFTA case decisions and relevant information on the website. See U.S. Department of State, ‘NAFTA Investor-State Arbitration’ <<http://www.state.gov/s/l/c3439.htm>> accessed 15 April 2012. Similarly, The ICSID has organised and published the previous decisions on the website. See ICSID, ‘ICSID Cases’ <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=Cases_Home> accessed 15 April 2012.

²¹⁴ UNCTAD, ‘UNCTAD IIA Issues Note, Interpretation of IIAs: What States Can Do’ (December 2011) <http://archive.unctad.org/en/docs/webdiaeia2011d10_en.pdf> accessed 15 April 2012.

drafting of indirect expropriation provisions in the KORUS-FTA, a negotiating state can agree to reduce the interpretative discretion of a tribunal by employing more precise language and detailed guidelines for treaty interpretation or by adding formal side agreements (e.g. the side agreements to the NAFTA) or informal side-instruments such as the exchange letters at the time of conclusion.²¹⁵ In addition, a nation-state could unilaterally provide purely national sources (e.g. statements or documents relative to the nation-state's interpretation of the treaty) to supplement tribunal deliberations, in the light of VCLT.²¹⁶

Additionally, Korea and the U.S. under the KORUS-FTA can use, for involvement in treaty interpretation, the KORUS-FTA Joint Committee which can issue opinions to bind an arbitrator's interpretation of the treaty text.²¹⁷ Article 22.2.3(d) allows the Joint Committee to issue opinions which bind the tribunal's interpretations according to Article 11.22.3 and Article 11.23.2. From a systems theory perspective, the Joint Committee could act as an emergency brake in a case where the tribunal did not appropriately consider national or public interests in the course of applying the law to the case.

However, the consistency produced by an investment arbitration mechanism could be undermined if the Committee were to produce *de facto* amendments under the guise of interpretation. Indeed, some tribunals have raised questions about whether the opinion of an FTA special committee is just an interpretation or a disguised amendment.²¹⁸ Those tribunals eventually recognised the binding effect of the committee's opinion,²¹⁹ though they remained silent on the nature of the 'interpretation' by the special committee.²²⁰ Even if the opinion expressed by the Committee cannot influence current or past arbitration decisions, it could deter future arbitration from referring to previous decisions in terms of the autopoietic networking of investment arbitrations. The nation-state needs to take a very careful approach to engaging in interpreting treaty in order to protect the autopoietic networking of GIL. Of course, it would be absurd to claim that

²¹⁵ *ibid* pp.8-10.

²¹⁶ *ibid* pp.11-12.

²¹⁷ KORUS-FTA Article 11.22.3.

²¹⁸ See generally David A. Gantz, 'The Evolution of FTA Investment Provisions: From NAFTA to the United States-Chile Free Trade Agreement' (2003) 19(4) *American University International Law Review* pp.716-20; Anthea Roberts, 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of State' (2010) 104(2) *The American Journal of International Law* p.225.

²¹⁹ *ADF Group Inc. v. United States of America*, ICSID No. ARB(AF)/00/1, Award, 9 January 2003; *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL (NAFTA), Award in Respect of Damage, May 31, 2002 paras.43-51.

²²⁰ *ADF Group v. United States of America* (n 219) para.177.

any engagement with tribunal interpretation is undesirable,²²¹ because such tools can persuade nation-states and other global actors to stay with the GIR by providing opportunities to readjust unreasonable tribunal interpretations.²²² Nevertheless, this does not mean that *any* such engagement should be permitted;²²³ if such activities change originally agreed normative expectations in an unacceptable way, the system as a whole looks less reliable to GIR members, especially global investors.

Given this, the involvement of states in interpretation should be made on reasonable and persuasive grounds founded on a general consensus among the relevant actors; for example, even if the issuing of the Committee's opinions cannot be considered to be a treaty amendment, the relevant procedures need to be carefully structured in a way that makes them more similar to amendment procedures. This is because it is possible for the committee to issue an opinion which has an effect similar to amendment, namely to change normative expectations. In this context, the issuance of opinions needs the participation of the relevant GIR member because the Committee's opinion is associated with changes in normative expectations which reflect wider social interests. Additionally, the negotiation process should not be unilaterally dominated by the executive branch. Therefore, the Korean government needs to establish a special committee which consists of members of the three branches and has the discretion to initiate discussion. While the legislature can consider civil society and business group opinions, the judicial branch should review legal issues of treaty interpretation in accordance with Korean national law. The National Assembly, based on a report of the special committee, then needs to establish the broad agenda and relevant principles. The Minister can then negotiate with the U.S government according to this agenda and these principles and conclude a deal with the other state party on condition of legislative approval. In addition to affairs concerning the KORUS-FTA Joint Committee, this special committee needs to provide advisory opinions when the executive branch prepares to use unilateral instruments (e.g. provision of a national statement or report concerning treaty interpretation).

iv) Establishment of an appellate body

The nation-state needs to be attentive in establishing an appeals mechanism which would supervise the operations of individual arbitration decisions in favour of doctrinal coherence against unjustifiable extra-legal influences. Many investment policy makers in nation-states seem to share

²²¹ UNCTAD (n 214) pp.2-5.

²²² *ibid* p.4.

²²³ *ibid* pp.4-9.

the sentiment of the necessity to establish such an appeals mechanism.²²⁴ Notably, the U.S. Trade Act of 2002 defines, as one of the negotiating objectives of U.S. free trade agreements, that of ‘providing for an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements’.²²⁵ This policy goal influenced the KORUS-FTA negotiations to the extent that Annex 11-D of the current KORUS-FTA prescribes that

[w]ithin three years after the date this Agreement enters into force, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 11.26 in arbitration commenced after they establish the appellate body or similar mechanism.²²⁶

At the multinational level, the ICSID has echoed this trend by initiating discussion of an appeals facility, which operates under ICSID’s auspices.²²⁷

On the other hand, some investment legal practitioners are sceptical about this project because of its practical problems.²²⁸ They argue that it may be unrealistic to believe that the establishment of an appeals mechanism will be a panacea for all of the problems in current GIL. An appellate body for investment disputes could cause more problems than it solves if it acts as a sort of investment constitutional court, vulnerable to a one-sided extra-legal thrust but not reflexive to other social values.²²⁹ Given the legal environment of the current global investment field, it is very difficult for an appellate body to discern consistent and coherent general rules of legal interpretation because each arbitration tribunal interprets a treaty text according to slightly different contexts or facts, even if those texts are similar to each other.²³⁰ Additionally, the system of investor-state arbitrations has not accumulated enough cases to produce consistent doctrinal rules, and the current state of GIL development has no urgent need for such air-tight consistency and coherence of jurisprudence, given that such concerns have been raised only in a few high profile cases.²³¹

²²⁴ Legum (n 88) pp.231-33; Qureshi (n 87) pp.1155-57.

²²⁵ 19 U.S.C. §3802(a)(3)(G)(iv).

²²⁶ Similar provisions are found in other U.S. free trade agreements. See Legum (n 88) pp.232-33.

²²⁷ ICSID, ‘Suggested Changes to the ICSID Rules and Regulations (Working Paper of the ICSID Secretariat)’ (12 May 2005) <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnouncePDF&AnnouncementType=archive&AnnounceNo=22_1.pdf> accessed 15 April 2012; ICSID (n 86).

²²⁸ e.g. Legum (n 88).

²²⁹ *ibid* p.238.

²³⁰ *ibid* pp.234-36.

²³¹ *ibid* pp.236-38. See also Judith Gill, ‘Inconsistent Decisions: An Issue to be Addressed or a Fact of Life?’ (2005) 2(2) Transnational Dispute Management.

The plausibility of the establishment of an appeals mechanism depends on the future development of GIL. Despite its pluralist setting, the terms and doctrines of GIL are, remarkably, standardised²³² enough to broach a unified multilateral investment treaty such as a MAI. As the GIR itself becomes more complicated and unpredictable, the current reputation-driven mechanism cannot satisfy the necessity for more predictable and consistent interpretative rules concerning the standardised terms of individual investment treaties. Although some degree of inconsistency found in judicial decisions is normal in any legal system, it is fair to say that the current degree of inconsistency found in investment arbitration decisions too often goes beyond an acceptable line. Thus, unpredictability caused by inconsistent decision making in investment arbitration is said to trigger nation-states to engage in more active involvement in treaty interpretation, or even treaty termination;²³³ some commentators point out that investment tribunals have suffered from interpretive inconsistency even in relation to the same clause of the same treaty.²³⁴

Moreover, it is an exaggeration to claim that an appellate body would obtain an unchecked judicial power if one considers constitutional dualism, i.e. legal periphery and centre. Such a judicial body (legal centre) will have a tensional relationship with GIR members, just like the dynamic between the national constitutional court and the people. Indeed, that appellate judicial body – just like other *ordinary* investment arbitration bodies and national courts – could be subject to public scrutiny. Further, regime members can change the rules of the game by amending norms if the decisions produced by the judicial body were unreasonably favourable to a particular social need.

Nevertheless, this issue seems to be open to future discussion in the context of establishing a global investment appeals mechanism, including reforms to the ICISD Convention. Practically speaking, a difficult question might be raised in relation to the ICSID Convention (to which Korea and the U.S. are both parties) in the context of the KORUS-FTA. Article 53 of the ICSID Convention principally denies the possibility for engaging other appellate procedures once an award is rendered by the ICSID tribunal. A commentator argues that even if Korea and the U.S. agree to establish an appellate court to review individual arbitration decisions, it may be doubtful that such an appellate court could consider decisions awarded by ICSID tribunals.²³⁵

²³² Tams (n 85) pp.236-37.

²³³ UNCTAD (n 214) pp.1-2.

²³⁴ Tams (n 85) pp.236-37.

²³⁵ Jeong (n 181) p.263.

However, if Korea and the U.S. agree to amend the treaty or establish an additional protocol or a separate agreement to the ICSID Convention in the effect to establish an appellate mechanism,²³⁶ it may be possible to circumvent Article 53 on the basis of an *inter-se* modification of the multilateral treaty specific to Korea and the U.S., under Article 41 of the VCLT.²³⁷

Nevertheless, it is questionable whether the establishment of an appellate body within the KORUS-FTA system alone will bring about desirable results for both countries and for the operation of GIL as a whole. Tams argues that the appellate body should be designed to be one single standing body with the comprehensive competence to hear appeals proposed in all investment disputes in order to cope with the inconsistency problem.²³⁸ For example, if the party can appeal to different appellate bodies according to different treaties, some degree of consistency might be secured within the jurisdiction of a specific treaty. However, it is still doubtful whether the inconsistency problem could be cured at the level of whole international investment law as a different appellate bodies could produce different rules; for instance, a decision of NAFTA appellate body would collide with a decision of KORUS-FTA appellate body if Korean and Mexican investors would raise claims on the same U.S. regulation according to different treaties.²³⁹ Secondly, the appellate body should be designed to have more competence to hear as many cases as possible in order to maximise the opportunities for the appellate body to create doctrinal consistency by influencing future investment awards.²⁴⁰ Lastly, the appeals system for investment arbitration requires the establishment of a standing body comprising a small number of arbitrators in order to increase institutional consistency in deciding investment disputes.²⁴¹

As a result, an appeals mechanism could not achieve its intended goals without a grand project such as an ‘international investment court’²⁴² or a ‘supreme investment court’²⁴³ in addition to the amendment of the ICSID Convention. No steps could be taken without political consensus motivated by the nation-state and the public opinion of global investors and civil society.²⁴⁴ In particular, proponents for the appeals mechanism need to propose practical

²³⁶ For example, the Article 11.20.12 of KORUS-FTA allows Korea and US to join a separate agreement for appellate body which are effective between two countries.

²³⁷ Tams (n 85) pp.230-31.

²³⁸ *ibid* pp.237-39.

²³⁹ *ibid* pp.237-38.

²⁴⁰ *ibid* p.238.

²⁴¹ *ibid* pp.238-39.

²⁴² Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) pp.180-84.

²⁴³ Qureshi, (n 87) pp.1165-67.

²⁴⁴ Tams (n 85) pp.229-30.

alternatives to appease the worries of small investors or countries who anticipate that the appeals mechanism carries the risk of increasing the burdens of time and financial cost in resolution of investment disputes.²⁴⁵ To summarise, it is practically impossible for unilateral or bilateral actions of Korea or the U.S. within the KORUS-FTA alone to bring about the desirable effects in the light of the autopoietic operation of the whole GIL.

V. CONCLUSION

As has been discussed above, indirect expropriation concerns could be considered to involve a conflict between the political rationality of the nation-state and the economic rationality of the global investor. The GIL transforms these bare social conflicts into legal conflicts among colliding interpretations of the same legal text. Host states attempt to interpret legal texts in favour of more regulatory power for the government, whereas foreign investors try to nullify such arguments by relying on the investment protection provisions.

Here, systems theory proposes contextual control by relying on legal autonomy to adjust various sub-social systems, including the nation-state. In contrast to the traditional welfare-state model, contextual control asks nation-states to intentionally stay away from the autonomous operations of the legal system. Therefore, nation-states refrain from dominating the production of the detailed substantive normative contents of indirect expropriation. Instead, they can participate as one of the global actors in the norm-making process in order to secure national regulatory power. On the other hand, nation-states consent to have recourse to independent dispute settlement, namely to investor-state arbitration, when a legal conflict between the host state and a foreign investor is raised regarding the interpretation of the substantive norms, such as indirect expropriation provisions. This tribunal is established independently but it is obliged to produce a balanced doctrine which proportionally adjusts various social interests, including national power. Although contextual control looks similar in appearance to the neo-liberal approach, the nation-state does not entirely lose its control over the global investment field because they can secure predictability in preventing the worst-case scenario.

Of course, the effective operation of this system requires GIL to maintain its dynamic autonomy through partial autopoiesis. In fact, GIL cannot be perfectly independent from the nation-

²⁴⁵ *ibid* pp.227-29.

states because nation-states have the most significant formal role in establishing treaties. At the same time, the legal system is also partially autonomous from many other sub-systems, which compete in using the legal system in favour of their own interests. Through this mechanism, the legal system can maintain a dynamic autonomy among competing social values by making simultaneous and equal contacts with sub-systems. In the language of systems theory, legal systems should form structural couplings with other social systems. Consequently, the concept of global law could be considered as ‘reflexive transnational law’,²⁴⁶ namely the global application of ‘reflexive law’ in the sense that contextual control guides the legal system to ‘conform to the conditions of the structural coupling’.²⁴⁷

In this context, the lessons of the system theoretic understanding of the constitution could help us to assess whether or to what extent GIL can make a sound structural coupling with other sub-societies. Of course, it might look doubtful that a global constitution is emerging in the global investment field. Nevertheless, the concept of such a constitution could at least be applicable to an analysis of the structural coupling between the legal system and other globalised sub-societies as long as the national constitution is considered to be one of the most representative examples of the structural coupling between the law and other sub-societies. According to this analogical analysis of national constitutionalism, this thesis has discovered several features of constitutionalism in global investment. It has also shown that, even if this analysis has demonstrated some degree of structural coupling between GIL and other sub-societies, that structural coupling is not fully developed. Eventually, the half-baked establishment of this structural coupling will threaten the dynamic autonomy of GIL itself by exposing GIL as a whole to inappropriate influences from other strong sub-societies such as the economic system. In order to correct such flaws, the Korean government needs to employ two general strategies in the context of the KORUS-FTA: it must protect the autopoietic operations of arbitrations in the organised sector and enhance the democratic participation of various social actors in the spontaneous sector.

²⁴⁶ Galf-Peter Calliess, ‘Reflexive Transnational Law: The Privatisation of Civil Law and the Civilisation of Private Law’ (2002) 23(2) *Zeitschrift für Rechtssoziologie*.

²⁴⁷ Teubner ‘After Legal Instrumentalism: Strategic Models of Post-regulatory Law’ (n 32) p.386. See also Paterson (n 17) p.563.

CHAPTER VI

CONCLUSION

I. THESIS SUMMARY

This thesis, so far, has discussed how the Korean government can control the global investment field. Within this topic, the thesis particularly analysed the global challenges and opportunities which are associated with the indirect expropriation doctrine under the investor-state arbitration of the KORUS-FTA.

Although there is no concrete definition of indirect expropriation, it is generally considered as a governmental action that has a similar effect to physical and direct expropriation without transfer of property. Initially, the doctrine of indirect expropriation was developed in the course of protecting foreign investment from arbitrary governmental measures. However, many critics argue that foreign investors have often abused this doctrine in order to attack various government actions which protect the national public interest. In response to such criticism, the drafters of KORUS-FTA have agreed to narrow the scope of the indirect expropriation doctrine by echoing Korean and U.S. property law and by accepting the recent development of the indirect expropriation doctrine. Therefore, a future tribunal under the KORUS-FTA is expected to employ a proportionality test which will compare the private and the public interest in reviewing the indirect expropriation claim. In this context, Chapter III argues that it is an overstatement to claim that the indirect expropriation doctrine of the KORUS-FTA is completely different from the Korean constitutional doctrine of property rights in its substantive aspects.

However, this thesis also contests the Korean government's assertion that the indirect expropriation provision does not challenge the Korean government's actions under any circumstances. The reason is that the Korean government delegates the traditional sovereign power of conflict resolution to the global system of investor-state arbitration. The investor-state arbitration allows the individual foreign investor to file a claim directly against the host state when the foreign

investor argues that the host state has breached its treaty obligations. Here, the tribunal operates autonomously, outside the national control, even if the arbitration is established by the consent of the nation-state. To be more specific, the tribunal under the investor-state arbitration interprets the substantive norms according to its own rules without any direct reference to national laws. This independent rule of interpretation is developed through the accumulation of other previous arbitration decisions. As a result, the possible tribunal established under the KORUS-FTA reviews the constitutionally justifiable government actions according to the transnational rules of the GIL. The nation-state would face a heavy amount of liability if the tribunal upheld the illegality of the government action because the relevant cases are usually associated with long-term and huge projects or with significant public interests. In short, the Korean government is expected to face a risk that investment arbitration could curb their public projects according to the transnational rule by delegating the conflict resolution power to another transnational institution.

This analysis leads to another profound question: why does the nation-state voluntarily assumes such a risk by relying on the GIL, rather than using its own national system? This question cannot be answered without a theoretical framework to account for both the substantive and the procedural aspects of global investment mechanism.

Chapter IV employs systems theory to examine the nature of the GIL that is emerging in the globalised investment field. According to systems theory, the global actors, in the functionally differentiated world, compete in order to represent their own sub-systems. At the same time, those global actors cooperate in establishing a regime in order to prevent overly severe competition or mutual ignorance from destroying the entire world. In this world, the nation-state has lost its supreme authority to control the global regime; its role is limited in the presentation of the political system as just one of numerous sub-systems. Meanwhile, the legal system evolves gradually into a global legal system, and the classic tie between the nation-state and the legal system becomes weaker. The global law, as one of the autopoietic social systems, takes up a special task in dealing with social conflicts within the global regime; the regime participants are persuaded by the specific legal function to stabilise their normative expectations. This function of law makes the global regime more durable in the long-run against short-term challenges.

The regime actors can avoid the risk of direct social conflict by relying on the global legal system. This function works under two structural elements of global law: the participation mechanism and the independent dispute settlement. The participation mechanism of the legal system allows the regime members to produce a normative expectation as a compromise among the competing social actors. Those actors participate in the norm-making process instead of their

intervening directly in each other's matter. Next, the legal system allows one actor to challenge the other actors not with hostile reactions but with the independent dispute settlement, when the others betray normative expectations. The structural mechanism of the global law attracts the regime participants to stay within the regime by promising the longer-term benefits of legal consistency or predictability concerning the originally agreed-upon normative expectations.

Ultimately, Chapter IV demonstrates that the GIR is emerging by applying the systems theoretic framework to the global investment field. The GIR is formed by the relevant global actors (e.g. nation-states, global investors and social activists) who cooperate and compete over a common issue (i.e., the balance between the restrictions and the protections of global investments). Although all relevant actors operate according to their different rationalities, their operations stipulate the operations of others; for example, investment cannot operate efficiently without the tactic or affirmative regulatory supports of the host state, and many nation-states do not seem to find any engine to boost the national economy without the attraction of global investment. Meanwhile, two actors are often involved in conflict in regards to regulatory power and property protection; investors want to prevent the host state from interfering with their business activities; the host state wants to prevent the abusive power of investors from causing public concerns over financial crises, environmental pollution or other issues. Such conflicts carry the risk of total paralysis of the entire global investment field, in which anyone cannot put down other actors permanently under its own rationality. In order to avoid such disastrous results, global actors gradually form a common ground, the GIR, in which they compete or cooperate based on some degree of expectation for their own interests (e.g. property protection, political controllability or social justice).

As the GIR become more fragile with increased regime complexity, the GIR requires the function of GIL to stabilise normative expectations, by setting up two elements of global law: openness of participation mechanism and autopoietic structuralisation and operations of dispute settlement. If one applies this framework to the issues relative to the indirect expropriation, the doctrine of indirect expropriation is established as a norm through the participation mechanism (e.g. treaty-making or policy proposals from various interests groups) of GIR members. This participation mechanism makes the normative expectations of the indirect expropriation doctrine reflective to various values of the nation-state, investors and other social actors. In spite of some degree of dissatisfaction, the stakeholders of the GIR might settle for the predictability expectations because the interpretation of the indirect expropriation clauses allows the GIR members to expect what actions will be clearly allowed or prevented in the future. Although the GIR members can suffer from conflicts about the interpretations of the clauses, this does not lead to the blunt

withdrawal of the normative expectation; the members can stick to the initially agreed norms by challenging the legality of interpretation in the independent dispute settlement.

This issue involves the following questions: Should we promote the evolution of the GIL? If so, what direction can the nation-state and the other regime members take to expand the relevant opportunities and to reduce the possible risks?

In order to address those issues, the Chapter V starts by analysing the current status of nation-state in the global investment regime. The current nation-state, as one of the GIR members, is required to *control the uncontrollable* GIR. Actually, the nation-state should attempt to get political advantage from global investment so as to gain public support. In this connection, the nation-state is required to deal with two demands: i) the nation-state should attract global investment within its own territories by promising the protection of foreign investment; and ii) the nation-state is required to control the global investment field in order to prevent global investment from inflicting unacceptable harm on the political system. However, the problem arises because the globalised investment field does not always follow the political intentions of the nation-states; too many functionally differentiated sub-societies are competing to control the GIR as the actors of the sub-societies operate autopoietically by ignoring or circumventing political control.

In dealing with those tasks, three choices are available to the nation-states: i) the nation-states can employ stronger control over the global investment field in accordance with the public or national interests (the welfare-state model); ii) they can give up control by relying on the expectation that absolute freedom of economic activity would automatically be conducive to the national prosperity (the neo-liberalist model); and iii) they can admit and creatively take advantage of the emergence of the GIL (the contextual control model). Among these options, this thesis argues for the third choice: that the nation-state can secure the minimum scope of control over the global investment field by using the GIL. The history of the GIL shows that both the welfare state and the neo-liberalist models seem to fail because both of them neglect the legal and social autonomies. Against this backdrop, this thesis proposes a form of contextual control by relying on the autonomy of the GIL: the nation-state does not directly dominate the production of the legal contents, whereas the nation-state creatively uses and constructs the structural elements of the emerging GIL. The contextual control is totally different from the neo-liberalist (no control) approach because the nation-state does not give up control but pursues a very active role in establishing the structural mechanism necessary to secure legal autonomy. In addition, this contextual control is different from the welfare-state model (direct control) in the sense that the nation-state does not dominate the legal system but manipulates the contexts (structures and

procedures) within which the GIR actors behave. In terms of contextual control, the nation-states themselves voluntarily construct the structural mechanism within which they work as one of the participants. Nevertheless, the nation-states do not relinquish their formal position as institutional designers.

Under the contextual control model, the nation-state, as one of many global actors, is involved in the participation mechanism which produces the normative expectations (i.e. norms). Such a participation mechanism allows all the relevant global actors to officially or unofficially graft their own interests into the legal system through investment treaty making. To take an example of indirect expropriation under the KORUS-FTA, the invisible pressure of the global economic system drives the nation-states to prescribe the indirect expropriation provisions for the purpose of attracting global investors. In addition, civil society can influence the negotiations and conclusions of the KORUS-FTA through various channels, such as the media or protests. Otherwise, economic actors or social activists could officially participate through the national procedures of the treaty making. Here, the nation-state does not give up control of the process of norm-creation because it can also participate in this process. To be more specific, the Korean and the U.S. governments, as discussed in Chapter III, drafted the provisions in accordance with their national interests by considering their own national legal doctrines. Through this participation mechanism, indirect expropriation can serve as a compromise which is reflexive both in relation to economic and social interests, and to the nation-states.

Next, the independent dispute settlement mechanism has the critical role in stabilising normative expectations. Even if the treaty text itself transforms social interests into legal language, it does not eliminate the possibility of legal conflict between the host state and a foreign investor. For example, indirect expropriation reflects both political and economic rationality, according to the principle that the foreign investor's rights shall be protected on the condition that these rights should not ignore the national interests in an unacceptable way. However, legal conflicts inevitably arise when two parties interpret the same text differently. For instance, the nation-state attempts to restrict foreign investment on the grounds of 'legitimate public welfare objectives'¹ which makes the relevant governmental action immune from the investment claims. However, the foreign investor would contend that the relevant government action is not within the conceptual scope of 'legitimate public welfare objectives'. In this situation, the global investor, facing such a disappointing situation, could take an extreme action such as the withdrawal of the investment if the nation-state dominates

¹ Free Trade Agreement between the Republic of Korea and the United States of America (KORUS-FTA) Annex 11-B(a)(iii).

the conflict resolution. In order to prevent this disastrous result, the nation-state consents to an independent dispute settlement which the global investor voluntarily respects. In the systems theoretic perspective, this mechanism holds the relevant actors to the original normative expectation despite the disappointing behaviours of other actors. To put it differently, those actors claim their legality before the tribunal without the withdrawal of their investment or costly government interference. This conflict resolution process is independent but not arbitrary because it has an obligation to consider all the arguments proposed by the relevant actors in the course of interpreting the treaty text through persuasive reasoning. Therefore, the dispute settlement mechanism can produce predictable rules to adjust the relevant interests of all global actors, including nation-states.

In the case of indirect expropriation, the recent tribunal decisions have shown a tendency to converge on the proportionality principle to balance public and private interests. In addition, the crucial attractiveness of the independent dispute settlement process is that this mechanism can produce a consistency and predictability by sticking to the original normative expectations through autopoietic operations. To be more specific, the investment tribunals under this system make decisions by citing the previous arbitration decisions rather than other external legal sources. Through this mechanism, the GIL can strike down the short-term interests of the actors by securing the long-term benefits of all the global actors, thereby securing predictability and consistency. Despite the unpredictability of the GIR, the GIL can help each GIR member to make decisions based on the predictability which is supposed to secure the minimum scope of the normative expectations in a balanced way.

The nation-state, like other GIR members, could also enjoy some of the benefits of global predictability in the unpredictable global world by relying on GIL. The nation-state does not lose all control over the global investment field because the legal system prevents the worst-case scenario in which the regulatory power of the state is ignored completely. First of all, the treaty text can reflect the national interests of the regulatory power because the nation-state can participate in the treaty making process. In addition, the proportionality principle produced by the investment tribunal can protect the legitimate regulatory powers of the nation-states against the private interests in a balanced way. Of course, GIL does not guarantee that a nation-state can perfectly achieve a specific political goal; for instance, the national interest has to be negotiated with investment protection and other social needs. Nevertheless, the nation-state can predict the broad scope of a transnational rule, which is not the best but also not the worst. Actually, the nation-state cannot ignore such a benefit as predictability and consistency, given the unpredictability and uncontrollability of the current global investment field.

Lastly, the thesis examines several high-profile measures which can contribute to reform of the current GIL. In order to make contextual control effective, the global investment field needs to secure the autonomy of the GIL. Here, legal autonomy does not mean closure toward the external influences of the sub-societies. Rather, the autonomy of the legal system can be established by making itself equally and simultaneously open to all the competing sub-systems. In the systems theoretic perspective, legal autonomy could be established through structural coupling between the legal system and other sub-social systems. To put it differently, as long as the structural coupling is not firmly established in the global investment field, the GIL cannot be expected to make the jurisprudence of indirect expropriation reflexive to various social values. In order to assess the degree of the structural coupling in the global investment field, the thesis analogically employs the system theoretic concept of the constitution, in other words, the structural coupling between the law and other social systems. This analysis demonstrates that structural coupling in the current global investment field is not fully fledged, so the lack of structural coupling corrupts the autonomy of the GIL. In response to such flaws, this thesis proposes several possible projects for the Korean government to contribute to the establishment of structural coupling in the context of the KORUS-FTA. Simply put, the Korean government should enhance public participation, which would make the normative expectations reflexive in the course of the treaty-making process. At the same time, the Korean government should protect the autopoietic operation of the investor-state arbitration which sticks to normative expectations in favour of consistency and predictability.

II. LONG-TERM STRATEGIES OF THE KOREAN GOVERNMENT

As long as the KORUS-FTA is formally in effect, the Korean government will find it difficult to terminate this. Such a quixotic action that the Korean opposition parties argue for could cause more risks than benefits.² Although it might be difficult to empirically prove that that signing the FTA attracts more foreign investment, it is relatively apparent that the termination of the KORUS-FTA might send negative signals to potential global investors. Given that the current indirect expropriation is not extremely against the Korean constitutional system, it is very questionable whether the unilateral termination of the KORUS-FTA will be beneficial to the

² The newly elected chairperson of the Korean main opposition Democratic United Party proclaims that the party will push the Korean President to terminate the KORUS-FTA if it will win the next general election in April 2012. See Chosun Ilbo, 'Han Myeong-sook "I am a pro-DJ" and "I Will Terminate the KORUS-FTA"' *Chosun Ilbo* (15 January 2012) <http://news.chosun.com/site/data/html_dir/2012/01/15/2012011501366.html?news_topR> accessed 15 April 2012.

Korean people, as long as Korea does not find an alternative model to maintain its economy without reliance on the global economy.

More fundamentally, this thesis argues that Korea – not only as an investment-importing state but also as an investment-exporting state – can be better off when it is staying within the GIR by relying on GIL. Firstly, Korea as an investment-exporting state can attempt to protect its investment from arbitral measures of foreign countries without apparent diplomatic conflicts – particularly with politically strong countries such as China. While Korean investors are allowed to seek a legal remedy individually through investor-state arbitration according to the GIL, the Korean government can achieve the goal of investment protection by simply saying to the host state ‘Follow the global rule’. In the current world, the unilateral measure of any single country including Korea might not work effectively for property protection of its citizens abroad. In this context, the Korean government can make a convincing excuse for the public need of property protection abroad without diplomatic conflicts with strong countries. Maybe, this GIL in a case could be more functional for Korean investors than when they resort to the Korean government. At the same time, Korea as an investment-importing country can prevent the side effect of foreign investment without sending extremely negative signals to the future investors of economically strong countries such as the U.S. or the U.K. To be specific, the Korean government can make BITs or FTAs to provide a promise of investment protection in order to attract more investors, whereas it can specify the terms of the BITs and FTAs in such a way to secure the minimum scope of regulatory power to restrict the investment.

Nevertheless, the current KORUS-FTA includes potential risks, which may occur in unusual situations, just like a delayed action bomb explodes only under certain conditions. In this context, the thesis proposes the following several long-term strategies for the Korean government and people to modulate the possible concerns, even if Korea does not possess the capacity for short-term strategies.

The National Assembly, based on a social consensus, needs to amend the current Korean Trade Procedure Act, to proclaim the general negotiation goals of the investment treaty and to strengthen democratic participation in the treaty negotiation and in committees established under the treaty. In accordance with these negotiation goals, the Korean government should propose a Korean Model BIT, which includes substantive norms such as indirect expropriation and investment arbitration procedures. In relation to norm-making, the Korean government and people need to keep in mind that no government has the right to force national and global investors to endure unnecessary abuses of governmental power to the same extent that the legitimate

governmental power should be respected for the essential constitutional task of the sovereign state. Therefore, it is not a wise option to eliminate the indirect expropriation clauses from the Model BIT. Instead, the government needs to initiate social discussion to specify its detailed contents through democratic participation by relevant social actors. For example, Korean civil society and academia need to discuss and clarify the concept of ‘legitimate public welfare objectives’ clearer in order to avoid alleged conflicts with the Korean Constitution.

Although the Korean Trade Procedure Act and the Korean Model BIT cannot directly influence the KORUS-FTA, which has already been concluded, they will serve as the standards in discussing the indirect expropriation concerns or arbitration procedures in the KORUS-FTA Joint Committee with the United States. Korea is supposed to evaluate the benefits and harms caused by the KORUS-FTA implementation according to the Korean Trade Procedure Act. In relation to oversight of treaty implementation, if Korea would have its Model BIT, it could serve as a guideline to assess whether and how KORUS-FTA investment tribunals work appropriately in the light of Korean government’s intention. If the Korean government recognise intolerable harms relative to the treaty implementation, it can use several channels. The Korean government, in a Committee on Service and Investment supervised by the Joint Committee, can discuss any procedural or substantive issues in regards to the implementation of the KORUS-FTA. Through this committee, the Korean government can propose amendments of the investment arbitration procedures or the indirect expropriation clauses in ways to promote structural coupling. Even if the Korean government cannot amend the treaty text, the Korean government in the KORUS-FTA Joint Committee can discuss the issuance of the interpretive statement. For example, the Joint Committees can guide the tribunal by specifying the detailed contents of ‘legitimate public welfare objectives’. Of course, it may not be easy to persuade the U.S. government to accept the Korean proposals unless the current KORUS-FTA seriously challenges the U.S. national system. Nevertheless, a certain political momentum can occur to amend the KORUS-FTA, as witnessed in the Korean candle protests against U.S. beef exports. At least, it is necessary that the Korean government is prepared for unexpected opportunities to amend the KORUS-FTA with the U.S. in the future by establishing an elaborate set of principles and strategies for negotiation through public discussion.³

³ At least, it is expected that the U.S. will not refuse to discuss the relevant issues that Korea raises. The USTR Representative, Ron Kirk, said that the U.S. will review any concerns that Korea broaches in relation to the KORUS-FTA in the Committee on Service and Investment although he stressed that the investor-state arbitration system is critically important for the U.S. interests. See Hong-Yeol Kim, ‘Reviewing Any Issued

Even without any substantive amendments, the Korean government can employ various national measures to guide indirectly the KORUS-FTA investment tribunal in order to interpret the treaty in a particular manner.⁴ For example, the Model BIT or the governmental statement for clarification of the treaty terms serves as a source that the tribunal can choose to refer to in the context of the VCLT. Although the future KORUS-FTA tribunal would ignore such government states or Korean Model BITs in interpreting the KORUS-FTA text, this could serve domestically as a guideline for Korean officials in reducing the risk of unnecessary investment disputes when they establish public policies. Of course, it is imperative for the establishment of contextual coupling that any involvement in the treaty interpretation is made under the negotiation goals which are established through the appropriate participations of the relevant actors.

III. PROSPECT OF CONTEXTUAL CONTROL

Although the Korean solutions proposed in Chapter V ultimately aim to contribute to the global establishment of structural coupling, global structural coupling cannot be completely and firmly established by just one or two nation-states because the global investment field consists of individually established treaties and pluralistic institutions. More significantly, too strong a globalised political system, dominated by a handful of powerful states, runs the risk of distorting the efforts of relatively small nation-states or social activists who attempt to establish a structural coupling in the current global investment field.

First of all, the current global investment field is still heavily influenced by the power games of the nation-states operating in the globalised political system. In this context, it is clear that the FTA's political implications cannot be ignored.⁵ In other words, the FTA could be motivated by such political purposes as foreign policy or national security. For example, the U.S. government has pursued FTAs with small Middle Eastern countries as important foreign policy instruments for the Middle Eastern area.⁶ The reason is that such economic ties could bind counterpart states with the same economic interests as the U.S. Ultimately, such a strategy makes it easy to persuade the

Raised by Korea – Interview with the USTR Representative Ron Kirk' *Hanguk Kyounje* (5 December 2011) <<http://www.hankyung.com/news/app/newsview.php?aid=2011120562251>> accessed 15 April 2012.

⁴ UNCTAD, 'UNCTAD IIA Issues Note, Interpretation of IIAs: What States Can Do' (December 2011) <http://archive.unctad.org/en/docs/webdiaeia2011d10_en.pdf> accessed 15 April 2012.

⁵ Olivier Cattaneo, 'The Political Economy of PTAs' in Simon Nicholas Lester and Bryan Mercurio (eds), *Bilateral and Regional Trade Agreements: Commentary and Analysis* (Cambridge University Press, 2009) pp.45-47.

⁶ *ibid* p.46.

relevant countries to favour the U.S. when they make political or international decisions. In this context, the U.S. has nothing to lose from the KORUS-FTA in terms of its North East Asian foreign policy. The alliance with Korea is one of the United States' major important traditional alliances in North East Asia, where the U.S. faces China and North Korea. In addition, Korea, as one of the ten largest trading countries in the world, has an economic effect on other Asian countries. Therefore, strong economic ties with Korea could create room to steer the Asian political and economic context, even allowing the U.S. to participate in the Asian regional economic community.⁷ The same goes for small countries, especially in the context of national security; some Asian countries such as Taiwan have tried to establish FTAs with the U.S. and other powers in response to the 'China challenges'.⁸ On Korea's side, an FTA regime could create a more stable international relationship in East Asia, in terms of national security, by binding those major states together under one common economic interest and reinforcing their traditional military and political alliances. In this political context, the Korean government has pursued FTAs with major countries such as Japan and the United States for reasons of economic prosperity and stable national security.⁹

These political impacts have negative effects on the GIL because they are likely to distort any structural coupling in favour of the strong powerful states. For example, the geo-political reason of the KORUS-FTA deters the Korean government from rejecting the 2004 U.S. Model BIT; as a result, even if the KORUS-FTA incorporates more Korean national legal doctrines than do the previous U.S. FTAs, the main contents of the treaty still could be seen as a mere update of the 2004 U.S. Model BIT, which is based on the U.S. regulatory taking doctrine. In addition, an imbalance of

⁷ Many Asian countries are interested in FTAs or other multilateral regional agreements such as the Korea-China-Japan FTA. This could lead to another huge regional economic (or political) community such as the EU. Given this trend, the KORUS-FTA model is expected to influence other Asian FTA models. Further, the KORUS-FTA could serve as a connection to a joint Asian-Pacific regional economic (or possibly political) scheme. In fact, the KORUS-FTA is open to a future state party in Asia, especially China and Japan, whether deliberately or not. For example, KORUS-FTA Article 24.4 (1) provided the following: 'Any country or group of countries may accede to this Agreement subject to such terms and conditions as may be agreed between the country or group of countries and the Parties and following approval in accordance with the applicable legal requirements and procedures of each Party and acceding country'. See Yong-Shik Lee, 'The Beginning of Economic Integration between East Asia and North America? – Forming the Third Largest Free Trade Area between the United States and the Republic of Korea' (2007) 41(5) *Journal of World Trade* pp.1116-23.

⁸ Cattaneo (n 5) p.46.

⁹ Wonhyuk Lim, 'KORUS FTA: A Mysterious Beginning and an Uncertain Future' (2006) 30(4) *Asian Perspective* pp.175-77; Nakryoon Choi and Hongshik Lee, *A Sectorial Assessment of a Korea-US FTA and Policy Implications for the Korean Economy* (Korea Institute for International Economic Policy, 2007) pp.41-78. See also Joo-Hong Nam, *America's Commitment to South Korea: The First Decade of the Nixon Doctrine* (Cambridge University Press, 2009); Terence Roehrig, *From Deterrence to Engagement: The U.S. Defense Commitment to South Korea* (Lexington Books, 2007).

negotiation powers between Korea and the U.S. might force the Korean negotiators, whether intentionally or unintentionally, to ignore the inputs of civil society. For instance, Korean government officials and the governing party, facing criticism from civil society, have emphasised the geo-political importance of the KORUS-FTA, which is expected to strengthen the military and political ties with the U.S.

Further, such unbalanced power relations in global politics run the risk of corrupting global projects to establish structural coupling in the global investment field. The alternative model BIT which some civil groups propose could serve as one of several ambitious solutions that reflect a variety of social interests and the interests of the investment-importing countries. Otherwise, the MAI could be an important founding step in establishing structural coupling in terms of the production of generally acceptable and reflexively normative expectations in the global investment field. However, it looks very unlikely that the major investment-exporting countries would voluntarily accept any such global projects as the alternative model BIT or MAI; the reason is that those major states would be reluctant to give up their model BIT in the negotiation process because of their own national interests. Even if a global consensus such as a MAI were to be established, its detailed contents would be very likely to be distorted by those major economically powerful states, as can be seen in the failure of previous MAI project. The same applies to the establishment of the unitary appeals mechanism in the global investment field, because it looks quite uncertain whether those major states would voluntarily bind themselves under the appellate judicial body.¹⁰ The strong nation-states would worsen the situation in league with the strong global economic systems. In fact, the global companies whose headquarters are located in the strong countries can have more influence on the treaty-making process that is initiated by those countries. Moreover, it is undeniable that the government policy makers, investment lawyers and global businessmen establish chemistry through invisible networking. Finally, the GIL is actually privatised unofficially or officially by the private economic actors with the political support from strong nation-states. The establishment of structural coupling is therefore destined to be extremely vulnerable to inappropriate external influences, as long as the political system dominates the global investment field and as long as the structural elements of political system are shaped by a combination of private economic actors and a small number of powerful states.

In the language of systems theory, the global investment field is situated in a poorly differentiated world society, which is unequally differentiated into sub-societies. Ideally speaking,

¹⁰ Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) pp.176-77.

the perfect type of legal autonomy can be established only in a perfectly functionally differentiated world, in which every relevant sub-society has the same degree of influence on the legal system through structural coupling. Compared to this, some sub-societies in the current GIR tend to have more influence on the legal system than others because the current world society does not reach the ideal status of functional differentiation. As a result, such a power imbalance among the sub-societies encroaches upon the autonomy of the legal system, as the structural coupling is easily distorted by those powerful sub-societies, such as the political system or the economic system. Along with an imbalance among the sub-societies, the inequality of power between the nation-states within the political system deforms the global investment field in a more serious way. Such double distortions curb the efforts of the nation-states and the global social movement towards structural coupling. Precisely speaking, the combination between some part (strong nation-states) of the political system and the emerging global economic system suppresses the other part of the political system (small nation-states) and global social movements. In this context, it is fair to say that the current problems of the global investment field are caused not by functional differentiation itself but by imperfect or unbalanced functional differentiation.

Currently, the poorly differentiated world society seems to be trapped in a dilemma between the perfect functional differentiation stage and the traditional territorial differentiation stage. At the very least, it seems impossible to turn back the clock to the traditional territorially differentiated world because the systems theory argues that globalisation as functional differentiation is an irresistible and inevitable process in the modern world.¹¹ Even if the world society has already departed from the traditional world, it has not yet achieved perfect functional differentiation. Additionally, the current world society has still not found enough critical momentum to break through the current in-between situation and to make significant progress towards the more ideal form of functional differentiation. Here, a vicious circle is generated as the failure to gain the critical momentum cripples, or even deforms, the development of the functional differentiation in turn.

Nevertheless, such a dilemma does not necessarily lead to a pessimistic view regarding contextual control, even if this does not guarantee a rosy picture either. If globalisation as functional differentiation is unstoppable, then the momentum toward more functional differentiation is supposed to be created dramatically and it may happen eventually even at an unexpected time and in an unexpected way. As the world becomes increasingly globalised and functionally differentiated, contextual control could become more effective. Political power and the economic system will be

¹¹ Niklas Luhmann, 'Globalization or World Society?: How to Conceive of Modern Society' (1997) 7(1) *International Review of Sociology*.

balanced with the emergence of other sub-societies. In this context, Luhmann paid attention to the potentiality of social movements.¹² Moreover, the major powers of the state are supposed to deteriorate within the political system. As Hardt and Negri have analysed, globalisation will cripple the traditional powerful states, such as the United States, and will hinder them from maintaining their political hegemony in traditional ways.¹³ For example, the political powers of the strong states often and unexpectedly seem to be threatened by even a small social group in the functionally differentiated globalised world, as in the Wikileaks scandal. To summarise, unstoppable functional differentiation will equalise the powers of nation-states within the globalised political system and the influences of the sub-societies in the world society. In proportion to the increase in functional differentiation, contextual control will be more workable in the future.

In this situation, any steps towards a global legal system could make a meaningful contribution to functional differentiation by binding the strong states to global legalism. Moreover, those steps could generate better conditions for contextual control through structural coupling. Of course, the initial stage of the global legal system would be easily influenced by strong political states such as the United States. Nevertheless, the global legal system could evolve independently once the system has been launched because no strong country could maintain control over the globalised world permanently. Along with unstoppable functional differentiation, the global legal system could eventually bind the founding states back into universal normative values such as the rule of law. This situation is evidenced by the so-called ‘blowback’ phenomenon in U.S. foreign policy, in which U.S. power is boxed up in the universal or ideological values such as democracy and human rights that the United States initiated.¹⁴ For example, although human rights were initiated by the United States to manipulate many undeveloped countries, ironically this value has deterred the United States from taking aggressive actions in its war on terror. In a similar vein, Posner warns that global legalism will not necessarily guarantee that the U.S. can advance its national interests because the U.S. may twist its own arm with the universal principles of the legal system.¹⁵

A similar situation exists in the global investment field. Historically speaking, the major frameworks of the GIL were initiated by major investment-exporting countries such as the United States. Those major countries intended to protect the private investments of their own people

¹² Niklas Luhmann, *Die Gesellschaft der Gesellschaft* (Suhrkamp, 1997) pp.847-65.

¹³ Michael Hardt and Antonio Negri, *Empire* (Harvard University Press, 2000).

¹⁴ Michael Hirsh, ‘At War With Ourselves: In Kosovo, America Confronts Its Own Ideals’ (1999) 299 Harpers.

¹⁵ Eric A. Posner, *The Perils of Global Legalism* (University of Chicago Press, 2009).

abroad from the governmental measures of other undeveloped countries. However, this legal system restricts not only the investment-importing countries but also the major investment-exporting countries equally. For example, the investor-state arbitration, as one of the important elements of the early GIL, did not always protect the national interests of the strong states, as seen in the *Metahnex* case, in which a Canadian investor challenged the U.S. environmental protection policy. In the case of the KORUS-FTA, the U.S. government could be challenged by a Korean investor to the same extent that U.S. investors could challenge the Korean government. Even if the initial legal system was oriented towards neo-liberalist ideology, the history of the global investment field shows that the current systems are gradually and continuously being updating itself in response to the criticism of the other social activists and the investment-importing countries. Figuratively speaking, even if the ship is built by a ship maker, the route of the ship is decided by its captain once the ship has been launched. Similarly, although the GIL was initiated by the major states, it does not necessarily favour the founding states. Likewise, *the present* that the legal orders are heavily dominated by the private actors does not necessarily dominate *the future* that those will be tied to neo-liberalist views.¹⁶ Of course, it looks harder for the Korean investor to win in the arbitration against the U.S. and for the civil society to drastically change the investor-orientated policies at the current corrupted (in systems theory language) state of GIL. If the persuasiveness and legitimacy of the GIL is enhanced through democratic participation by more various global actors, however, the political influence on the GIL will wither away. In the end, the global public opinion by use of GIL could beleaguer the political hegemony of strong countries or the blind expansion of global investment as seen in Gramsci's understanding of 'the war of position'.¹⁷ In this context, the GIR will be controlled not only by those major states or private economic actors, but also by various other actors in the GIR, once it has been launched. The legal system, floating on the sea of the colliding sub-societies, has a tendency to follow its own evolutionary path. On this point, a contextual controller like a sailor can catch the opportunity to manipulate the ship of the legal system. Consequently, the efforts of small countries such as Korea or of global activists could become more effective in establishing structural coupling, as the economic system and the strong countries' powers in the globalised world are balanced by other emerging sub-societies.

¹⁶ Burkhard Schäfer and Zenon Bankowski, 'Emerging Legal Orders. Formalism and the Theory of Legal Integration' (2003) 16(4) Ratio Juris.

¹⁷ Antonio Gramsci, *Selections from the Prison Notebooks of Antonio Gramsci* (Quintin Hoare and Geoffrey Nowell-Smith ed, Lawrence and Wishart, 1971).

IV. TO EAT OR NOT TO EAT?

Nevertheless, this thesis does not perversely insist on the contextual control of the nation-state. Actually, a sailor may not be able to perfectly control the ship because the ship might be stranded due to unexpected environmental changes, such as storms. Likewise, the contextual controller cannot guarantee the success of contextual control over the global investment field because contextual control is very vulnerable to unpredictable future situations. To put it differently, nobody can anticipate how and when the GIR will catch the momentum which will enable it to break through the current dilemmatic global situation, to the same extent that nobody can deny the possibility of such a critical momentum. Whether or not the nation-states will take contextual control depends entirely on the choice of the national peoples who live in the present globalised world. Figuratively speaking, the KORUS-FTA looks like the poisonous apple in *Snow White and the Seven Dwarfs*; if the princess did not take a bite of the apple, she would not meet the prince. However, the marriage with the prince does not necessarily guarantee her a happy life, and in taking it she loses the chance of 'living happily ever after' with the seven dwarfs. In any case, nobody should be her stepmother, a wicked Queen who tricked Snow White into eating the apple so as to take some risk. To the same extent, nobody has a right to forbid the princess from eating an apple as a chance to meet the prince. If the princess is to be considered as an awakened subject, she should have a fair chance to compare the risks and opportunities.

Nevertheless, this thesis still carefully propounds the contextual control based on legal autopoiesis for handling the global investment issues. Of course, the establishment of structural coupling could be a very painstaking job because structural coupling is a very sophisticated process and it is easily corrupted. Additionally, contextual control needs to overcome numerous obstacles in the current GIR, which has several flaws in the light of structural coupling. Nonetheless, it is too early merely to give up an autopoietic approach because of several flaws in the approach without careful analysis. Consequently, this approach may require more sophisticated research on whether the relevant problems can be solved with a more profound and genuine understanding of the autopoiesis. Especially, this thesis argues that contextual control can be proposed as a convincing solution, given the history of the global investment field. As has been discussed above, the huge experiments of the welfare-state model and the neo-liberalist model in the 20th century seem to have failed with the emergence of the unpredictable globalised world. On the other hand, the autopoietic approach to the nation-state is still in the experimental phase, in the sense that the current GIR has not established an autopoietic structural coupling in the strict sense of Teubner and Luhmann.

Given this situation, the nation-state can consider the contextual control of systems theory as one of the potential experimental approaches that may be adopted in the 21st century, in which the nation-state is required *to control the uncontrollable and to predict an unpredictable world*.

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